Nos. 237 and 290

FILED
JAN 9 1959
JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *Petitioner*

vs.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA AND THE EQUITY ANNUITY LIFE INSURANCE COMPANY, *Respondents*

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*

vs.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA AND THE EQUITY ANNUITY LIFE INSURANCE COMPANY, *Respondents*

On Writs of Certiorari to the United States Court of Appeals For the District of Columbia Circuit

BRIEF FOR RESPONDENT VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA

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BRIEF FOR RESPONDENT VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA

INTRODUCTORY.

These two proceedings result from separate petitions for certiorari by NASD[1] and SEC in a single

[1] Abbreviations used in this Brief: Parties: SEC—Securities and Exchange Commission; NASD—National Association of Securities Dealers, Inc.; VALIC—Variable Annuity Life Insurance Company of America; EALIC—The Equity Annuity Life Insurance Company.

Record: P. Ex. and D. Ex.—trial exhibits of plaintiff or of either defendant; F.F.—trial court Findings of Fact; R.—printed record; Ct. App. Br.—Court of Appeals brief of party indicated; Br.—Supreme Court brief of party indicated.

action in which they sustained adverse judgments in both lower courts. VALIC files this single Brief in response to the separate briefs of SEC and NASD.

QUESTIONS PRESENTED.

VALIC being a life insurance company engaged in the sale of life insurance and variable life annuity policies with the approval and under the supervision of the Superintendent of Insurance of the District of Columbia and of the insurance commissioners of the several States where it operates, did the Court of Appeals err in holding:

(i) that policies issued by VALIC are annuities;

(ii) that VALIC is engaged in the "business of insurance" which is excluded from the regulatory jurisdiction of SEC by the McCarran-Ferguson Insurance Regulation Act (Act of March 9, 1945, c. 20; 59 Stat. 33, as amended; 15 U.S.C. §§ 1011-1015, hereafter sometimes cited "McCarran Act");

(iii) that VALIC is not required to register its policies with SEC under the Securities Act of 1933 (Act of May 27, 1933, c. 38; 48 Stat. 74; 15 U.S.C. §§ 77a *et seq.*, hereafter sometimes cited "1933 Act"); and

(iv) that VALIC is not an "investment company" subject to the Investment Company Act of 1940 (Act of August 22, 1940, c. 868; 54 Stat. 789; 15 U.S.C. §§ 80a-1 *et seq.*, hereafter sometimes cited "1940 Act"), and the requirement thereof which would prohibit the issuance of policies duly approved by the insurance authorities.

STATUTES INVOLVED.

The 1933 and 1940 Acts and the McCarran Act have been set out in the Briefs of SEC and NASD. Title 35 ("Insurance"), District of Columbia Code, 1951 edition, and Supplements thereto, of which chapters 3 to 8, inclusive, deal with the Life Insurance Act, are pertinent herein. Appendix VI to this Brief contains that portion of the Life Insurance Act appertaining to disclosure.

COUNTER-STATEMENT.

The variable life annuity policy [2] provides the annuitant an income for the uncertain period of his life, not in fixed dollar amounts, but in variable dollar amounts determined under the precise provisions of the policy and keyed to the insurance company's investment experience, based upon the scientific application of actuarial principles of life contingencies.

Variable annuity policies are "a means of providing a retirement program under which benefit payments tend to vary with cost of living charges" (*sic.*—Read changes, F.F. 29, R. 100). The problem arises from the impact of cost of living changes on the income of retired persons. One receiving a $2500 pension or retirement income in 1940 would by 1951 have had to receive

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[2] Note on terminology: SEC at the outset of its Brief refers to VALIC's policies which, says SEC, "they describe as 'variable annuities'" (SEC Br. 3), as though this were a new name invented by VALIC. VALIC will not engage in semantic argument. The name variable annuity, in use for years before VALIC was organized, has been accepted in legislation, court decisions, and insurance textbooks. VALIC describes its operations in what SEC calls "insurance terminology" (SEC Br. 3 fn.) because VALIC is a life insurance company engaged solely in issuing policies guaranteeing life contingencies, and any effort to state its operations in less appropriate language distorts them.

$4500 to have the same purchasing power.[3] An individual's annuity plan is a long-term program which may be in force for fifty years or longer. Long-term trends are the ones that count in retirement planning, not the day-to-day or month-to-month fluctuations of the stock market. The variable annuity policy, which pools and distributes the individual risk of longevity, can be made available to the public only by organized and regulated life insurance companies (R. 441). The expert actuarial mathematics to say nothing of the other insurance techniques and "know-how," on which variable annuity policies are based, dramatically illustrate how far they are from being a security and how far the business of writing and selling them is from that for which SEC has had training or experience.

VALIC's every operation is subject to the pervasive supervision of the insurance officials of the District and the several states in which it is duly authorized to do business.

VALIC, therefore, is not resisting regulation. It is resisting the attempt of SEC to impose on it a regulatory jurisdiction under Acts inapplicable to, and destructive of, its operations, contrary to the clearly expressed intent of Congress.

The facts sharpen by a specific example:

Early in 1957, Grenville Clark, a 74 year old New York attorney, applied to EALIC for a variable annuity policy (D. Ex. 102, R. 306, 877; R. 305, 385).[4] For a $30,000 premium, EALIC issued its policy specifying (a) annual payments for life, ceasing on death, the first due February 1, 1958, the dollar amount of

[3] D. Ex. 30, R. 406, 841, showing Cost of Living Index increase from 60 to 108, or 80%, in the years 1940-1951.

[4] EALIC's policies are substantially identical to VALIC's. F.F. 23, R. 99.

each measured by the value on payment date of 3827.50 annuity units; (b) the value attributed to each annuity unit on November 1, 1956, $1.00; and (c) the precise mathematical formula for adjusting this value thereafter (R. 878). The dollar "amount of the annuity payments," determined in accordance with the provisions of the policy, "will vary with the investment experience of the company," but cannot be affected by company operating expenses or by variations in the company's mortality experience from that of the Progressive Annuity Mortality Table (D. Ex. 102, R. 306, 877, 878).

By this policy:

1. Clark's right to a determinable annual amount, established by his sex and age, continues so long as he lives, regardless of how long this may be; and terminates on his death. SEC experts knew of no "security" having such characteristics (R. 306, 395, 404).

2. Clark's risk of outliving his capital is shifted to the company, which guarantees the mortality assumptions and, subject to such guarantee, distributes the risk among the group of annuitants. Both petitioners conceded below that this is an insurance function (SEC Ct. App. Br. 15, 31-32; NASD Ct. App. Br. 35-56). SEC recognizes "the mortality feature which determines the duration of payments by the companies" (SEC Br. 11, see also 13, 16).[5]

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[5] NASD (Br. 20, 42) still asserts that the variable annuity policy does not shift even the risk of loss attendant on the contingency of longevity. But NASD admits however (Br. 45) that by VALIC's guarantee of mortality, it takes "the calculated risk" that excessive longevity (which NASD translates as usual to inappropriate securities terminology) "may require it [VALIC] to dip into its surplus, if any, or the capital contributions of its shareholders." This admission concedes VALIC's assumption of the mortality risk inherent in its policies.

I

VALIC IS A LIFE INSURANCE COMPANY WITH CORPORATE AUTHORITY LIMITED SOLELY TO THE BUSINESS OF INSURANCE APPERTAINING TO PERSONS.[6]

VALIC is a stock life insurance company, capital and unassigned surplus over $600,000, authorized since December 30, 1955[7] to transact business under the Life Insurance Act (District of Columbia Code, 1951 ed., Title 35, chapters 3-8, hereafter cited "L.I.A.").

The Corporation Counsel of the District of Columbia on three occasions, has certified (as required by L.I.A. § 35-503) that VALIC's purposes and corporate structure conform to District insurance law. SEC does not contend otherwise.

VALIC (complying with L.I.A. § 35-415) deposited with the Superintendent of Insurance of the District of Columbia (hereafter "Insurance Superintendent"), for the benefit of its policyholders, securities initially valued at $100,000, later increased to over $200,000. VALIC's Articles of Incorporation and amendments were approved by the Insurance Superintendent, and VALIC was authorized to do business (L.I.A. §§ 35-503, 35-705).

The policies issued by VALIC have been approved by the Insurance Superintendent (L.I.A. § 35-705) (R. 506) "for sale as annuity contracts" (SEC Pet. for Cert., p. 3).

Prior to the trial, insurance commissioners of West Virginia, Kentucky, and Arkansas had authorized VALIC to transact its insurance business in those

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[6] The authorities for this summary are F.F. 3-16, 19-21, and 27; R. 94-100, R. 506; and D. Exs. 2, 4 (not printed), 6, 8, 13, 15, 20, R. 406, 814, 817, 823, 832. They will not be individually cited.

[7] The statement (NASD Br. 4) that "VALIC was first 'authorized to transact' " its business in the District on April 30, 1956 is one of many factual errors in the Petitioners' Briefs. See F.F. 5-6, R. 95-96.

states, and also had approved its policy forms. Since the trial, VALIC has been authorized to operate in Alabama[8] and New Mexico.[9] EALIC has been authorized to do business in North Dakota.[10] State insurance statutes and regulations provide for detailed supervision of VALIC by the respective insurance authorities.

VALIC's policies are offered to individuals and groups through the general agency system commonly used by life insurance companies. "Every general agent and every agent selling any VALIC policy [is] and must be licensed by the Insurance Department in either the District of Columbia or the State in which VALIC operates" (F.F. 25, R. 99).

In the District and in Kentucky, annuity premiums paid to VALIC are subject to state tax of 2%; in Arkansas, 2½%; in West Virginia, 1% (F.F. 27, R. 99-100); in Alabama, 1%; and in New Mexico, 2%.

II

VALIC'S POLICIES.

VALIC's seven approved annuity policies fall into two categories, individual and group (F.F. 31, R. 101).

A. GENERAL.

1. Annuity benefits.

Each VALIC policy obligates it to pay an annuity in amounts determined pursuant to the contract, continuing for the life of the annuitant.[1] All the assets

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[8] Copy of Alabama certificate of authority is printed as Appendix II hereto, p. 6a.

[9] Copy of New Mexico certificate of authority is printed as Appendix III hereto, p. 7a.

[10] Copy of North Dakota certificate of authority is printed as Appendix IV hereto, p. 8a.

[1] For brevity, VALIC throughout this brief will discuss the issues in terms of the straight life annuity, without refund at

of the company stand behind this obligation (SEC expert, R. 282, 296).

From the standpoint of actuarial principles, variable and fixed-dollar annuities are identical (R. 470, 487). The essential function of the issuing life insurance company is to liquidate the company's aggregate liability to the annuitant group over the uncertain life spans of the individual policyholders, some of whom (unidentifiable in advance) will die early and some of whom will live long.[2] Reserves released on early death are available to assure payments to the long-lived (R. 458-459). "The company has to have some mortality profit on early deaths to offset the loss on deaths later on" (SEC expert, R. 255). Under VALIC annuities:

> ". . . payments to the annuitant are calculated pursuant to actuarial principles of life contingencies predicated upon an assumed annual investment increment rate in such manner that the annuity payments will remain uniform in dollar amount if actual investment experience conforms to the assumed investment increment rate. The contracts provide that the amount of the payments to the annuitant will vary only to the extent that the actual investment experience varies from the

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death. VALIC offers the annuitant options (customary in insurance annuities (SEC expert, R. 233)), providing payments (a) over the longer of two lives, or (b) over a 10 year period certain and thereafter for life. Involving identical actuarial principles, these need not be discussed separately.

SEC's insurance expert confirmed that VALIC's policy provisions were common to virtually all deferred or optional life insurance annuities: maturity date, election of an alternate maturity date by the annuitant, monthly annuity payments, cash surrender values, option to terminate in advance of annuity, payments to beneficiaries on annuitant's death during premium payment period, policy loans, non-forfeitures, misstatement of age, etc. (R. 232-238).

[2] SEC recognizes VALIC's obligation to pay for life, though such life exceeds normal expectancy (Br. 8).

assumed investment increment rate" (F.F. 30, R. 100-101).

The actuarial problem involved in the liquidation of the group liability is to schedule the annuity payments on a basis fair both to the short- and the long-lived. To do this, actuaries must base their calculations on a realistic assumed net investment rate and a conservative mortality table (R. 496. See SEC expert, R. 177).[3]

The assumed investment rate: The actuary uses an assumed investment rate to assure that each annuitant will participate equitably both in the assets underlying the reserves for future annuity payments, and in the earnings thereon pending the ultimate liquidation of those assets. Should the actuary ignore expected earnings, initial annuity payments would be too low. Later annuity payments would have to increase to liquidate the group reserve at the death of the last survivor (R. 495-496). The opposite inequity would arise from use of an unduly liberal assumption in calculating the initial payment.

VALIC uses an assumed net investment rate of 3½ per cent per annum in the actuarial calculation of

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[3] No useful purpose would be served by an elaborate discussion of actuarial mathematics. Though SEC thinks that VALIC's contract provisions involve a "rather complicated formula" (SEC Br. 23 fn), SEC's insurance actuary confirmed that all amounts were precisely determinable as the occasion for calculation arose (R. 254). The trial court found that the amount of the annuity payments is prescribed by contract (F.F. 30, R. 100-101).

Actuarial calculations involve an advanced field of mathematics. Admission to the Society of Actuaries is based on a comprehensive examination. The mathematical parts of the examination "include advanced algebra with special emphasis upon the theory of probability, the theory of compound interest, finite differences, the differential and integral calculus, and statistics." 1 ENCYCLOPEDIA BRITANNICA 145 (1948) "Actuary."

the initial annuity payment. This assumption is built into the initial and all subsequent annuity payments, so that if the net investment rate of VALIC were at all times precisely 3½ per cent, the amount of the annuity payments would not vary. The net earnings rate of United States life insurance companies for 1915-1957 averaged over 4 per cent.[4] SEC has admitted (SEC Ct. App. Br. 7) that VALIC's assumption of 3½ per cent "is made to take care of such normal income as might be anticipated."[5]

Although no witness criticised VALIC's actuarial calculations, NASD seeks to imply that VALIC assumes no substantial mortality risk (NASD Br. 44, fn. 1 because VALIC annuity payments are "less than $10 per $1000". (NASD Br. 44). The record shows that VALIC's annuity obligations, as approved by the several insurance commissioners, are in accordance with current practice of other life insurance companies. The amounts, of course, depend on the age and sex of the annuitant or annuitants (joint and survivor) and the option selected. On a straight life annuity, the initial monthly payment ranges from $4.28 per month for a 50 year old female to $8.22 per month for a 70 year old male (P. Ex. 1, R. 125, 567 at 568-569). The initial monthly payment of $6.81 for a 65 year old male compares to $6.75 and $6.50 provided respectively by Lincoln National Life Insurance Co.

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[4] 1958 LIFE INSURANCE FACT BOOK, p. 59.

[5] P. Ex. 4, R. 142, 647, shows that during the first six months of the Series 2 policies, VALIC's net investment rate was 1.7 per cent; during the year ended March 31, 1957, it was 3.8351 per cent. *Misstatement:* NASD Br. 44, fn. 3, asserts that VALIC's counsel "conceded" that VALIC had "never earned as much as 3½ per cent on its funds." The source cited (R. 545-546) shows that VALIC's counsel, answering an inquiry by NASD counsel, pointed out that the net investment factor on VALIC operations was shown in P. Ex. 4.

and Canada Life Assurance Co. (D. Ex. 41, R. 547, 853).

Mortality table: All VALIC policies guarantee that annuity payments will continue for the life of each annuitant (F.F. 30, 33-A-i, R. 100-101, 102; SEC expert, R. 255). VALIC assumes this guarantee the day it issues the policy, though annuity payments may not commence for decades (F.F. 33-A-i, R. 102; R. 461, 463-465, 494; SEC expert, R. 248-250).[6]

Improved life expectancy over the past 70 years evidences the significance of this mortality guarantee. The Society of Actuaries has published numerous revised mortality tables reflecting decreased mortality (SEC expert, R. 250-251). ". . . The 1941-58 increase [in life expectancy], largely a result of antibiotics and other medical advances, is about equal to the life expectancy increase in the United States between 1858 and 1941."[7] A life annuity policy written by a life insurance company in 1910, maturing in 1950, calculated on the American Experience Table of 1868,[8] would commit the company to payments substantially in excess of those justified by present experience (SEC

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[6] VALIC's annuity obligation is quite unlike the commitment of the insurance company (referred to SEC Br. 32) which purports to offer stockholders of Advisers Fund, Inc. an opportunity at some future date to obtain a fixed-dollar annuity, but ". . . reserves the right to withdraw the offer or modify the rates or other terms of the commitment with respect only to the proceeds from liquidation of shares acquired subsequent to due written notice sent to the affected stockholders . . ." (P. Ex. 48, R. 805 at 808). SEC recognizes (Br. 32) that an investment company cannot issue a life annuity but must operate under "arrangements with an insurance company." The insurance company receives the premium and "converts" the value to an annuity, and the annuity policy is not registered with SEC.

[7] TIME MAGAZINE, December 29, 1958, p. 13.

[8] 10 TRAN ACTUARIAL SOCIETY OF AMERICA, 509-514.

expert, R. 247-249).[9] The Progressive Annuity Mortality Table[10] used by VALIC's actuaries was designed for use in annuity calculations (SEC expert, R. 252-253), and "gives effect to the guarantee that such payments will be continued during the status [i.e., life] for which the contract provides" (SEC expert, R. 194).

Each VALIC policy, at issuance, fixes the amount of the initial annuity payment in dollars per $1000 of reserve applied. This amount is reported to the policyholder at the inception of annuity payments in terms of "annuity units". Annuity units are statistical reporting symbols which are not a part of the company books of account (F.F. 37, R. 105). When annuity payments begin, the number of annuity units remains fixed (P. Ex. 1, R. 125, 567, at 573, par. 20).

2. Standard policy provisions.

VALIC's annuity policies include the "Standard Provisions for Annuity Contracts" required by L.I.A. § 35-705 when appropriate to the type of policy (F.F. 34, R. 104; P. Ex. 1, R. 572-574).

B. TYPES OF POLICIES.

1. Individual annuity policies.

a. Immediate Life Annuities.

VALIC's three forms of single premium immediate individual life annuity policies (P. Exs. 7, 8, 9, R. 206-208, 677-688), as their title makes clear, involve no

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[9] NASD states that VALIC's mortality guarantee "is meaningless" (Br. 16). But NASD says (Br. 17), "experienced departures from the expected mortality . . . in the direction of longer . . . life, could have no effect on the operation of the basic formula which describes VALIC's obligation to pay under its contract." Precisely because such departures do not change the amount of VALIC's contractual annuity payments, VALIC's guarantee shifts the risk of increased longevity from the annuitants to VALIC.

[10] Published in ANNUITY TABLES, SOCIETY OF ACTUARIES (1952).

period of premium payments. They become payment obligations forthwith. The actuarial techniques, which are those for determining the annuity payments, have been described above.

b. Deferred [Optional] Life Annuities.

Most individuals must acquire their life insurance estate and their annuity for retirement by premium payments spanning their productive years.[1] The standard life insurance procedure on deferred annuities is to accumulate as a "sinking fund" reserve the net premium applied to provide annuity benefits (SEC expert, R. 188-189, 278), and to determine interim cash values by adjusting such accumulating amounts by investment results (R. 526-529). The only difference between a participating fixed-dollar annuity and a variable annuity is that the former adjusts by an assumed investment rate, 2 per cent to 2½ per cent, and distributes part of the excess as dividends; the variable annuity adjusts reserves by actual investment experience (R. 471, 497).[2]

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[1] 98 per cent of all ordinary life insurance is bought on a premium payable annually or more frequently (1956 LIFE INSURANCE FACT BOOK, Ct. Ex. 1, p. 20). 75 per cent of individual deferred annuity policies are in the pay-in period (id., p. 81).

[2] D. Ex. 41, R. 537, 853, shows the parallel between the cash value on fixed-dollar and variable annuity policies. Two typical fixed-dollar, participating policies are compared with a VALIC policy. It is assumed that (a) on the fixed-dollar policies, dividends at the current rate accumulate at interest; and (b) on the VALIC policy, the net investment rate averages 3½% per annum. On identical assumptions of age, sex, and premium, typical cash values are:

	Lincoln National	Canada Life	VALIC
After 5 years	4,557.80	4,413.80	4,409.06
10 years	10,351.20	10,221.50	10,176.22
20 years	24,910.20	24,775.70	25,525.20
30 years	44,569.10	44,275.80	46,902.52

NASD charges that VALIC cannot comply with the reserve requirements of District insurance law (Br. 36). This conflicts with the certificate of the Insurance Superintendent, who periodically examines and certifies VALIC's reserves (D. Ex. 1, R. 270). It conflicts with the testimony of SEC's insurance expert, who emphasized that he questioned neither the method of calculation nor the adequacy of VALIC's reserves (R. 275). It conflicts with the testimony of Maclean (R. 486-487), the distinguished actuary recognized by seven citations in the NASD Brief. Of a similar charge made by NASD in a brief recently filed in West Virginia, the Insurance Commissioner of West Virginia has stated:

> "The Insurance Commissioner [of West Virginia] has caused to be valued on two separate occasions, 1956 and 1957, the reserves maintained by the defendant [VALIC]. The reserves have been found to be an accurate reflection of the Company's policy liabilities."[3]

VALIC reports annually to each policyholder the amount of the accumulated cash value of his policy. This is analogous to reports by participating companies with respect to dividends or excess interest payments (R. 527). In these reports, VALIC uses "a statistical device referred to as an 'accumulation unit' [which] . . . is a symbol designed and used for the purpose of keeping the policyholder informed as to the cash surrender value of his policy and the investment experience of the company. . . . VALIC has no account reflecting 'accumulation units' " (F.F. 36, R. 105). VALIC's books of account, like those of

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[3] Brief of *Amicus Curiae* on behalf of C. Judson Pearson, Insurance Commissioner, in *State ex rel. Sims, Commissioner of Securities* v. *VALIC*, Cause No. 24,449, Circuit Court, Kanawha County, West Virginia. This case is hereinafter discussed.

any other life insurance company, are kept on a cash basis (R. 524). Save for its use as a reporting symbol, the accumulation unit has no function (R. 525, 565).

SEC, in various shades of language, contends that "accumulation units" or "annuity units" represent the individual policyholder's "aliquot share" or "interest" in a "fund" of securities "purchased with his money" (e.g. SEC Br. 5, 6, 16, 36). These contentions ignore the relation between an insurance company and its policyholders. Each annuity purchaser buys protection against longevity, for which he pays a total consideration, part in cash premiums and part in his agreement that the company's liability with respect to his policy terminates at his death. VALIC undertakes the mortality guarantee and receives the premium. Like any insurance company, it balances its inflow of cash with its outgo for expenses and policy liabilities. When excess cash develops, it invests those funds in media legal for life insurance companies under the District Life Insurance Act. Over $100,000 of its assets were on deposit with the Insurance Superintendent before there was a policyholder: how does a policyholder acquire an "aliquot" share in these securities?

VALIC's reserves are adjusted upon the net investment experience of all its investable assets, including assets derived from the stockholders. Yet in the event of excessive longevity of the group, the stockholders supply the funds to satisfy VALIC's mortality guarantee (conceded, NASD Br. 45): in such event does the annuitant's "aliquot part" increase? And finally, at the annuitant's death, with liability ceasing, does his "aliquot share" evaporate?

The basic fact is that VALIC has no "fund" as that term is used in the Investment Company Act of

1940. An annuitant has no "interest" or "aliquot share" in VALIC's assets, or in any part thereof. An annuitant, like any creditor or other holder of a contract obligation, owns no part or share of the obligor's assets. Count Three of the original Complaint (R. 6) proceeded on the theory that VALIC had a "fund." Finding the charge groundless, SEC explicitly abandoned it (SEC Trial Brief 71; SEC Ct. App. Br. 3, fn. 3).[4]

Examination of the structure of United Fund, Inc. which SEC claims is "similar to" VALIC (SEC Br. 31), shows the fundamental difference between an investment company and VALIC or any other life insurance company.

When the United Fund Prospectus (P. Ex. 15, R. 341, 726) is examined closely, the organization and affiliation of these corporate or individual entities

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[4] A flagrant inaccuracy appears when NASD (Br. 8) asserts that "VALIC's expert witness, Maclean, testified that VALIC's operations during the premium payment period are similar to those of an investment company" (R. 492-493). We quote Maclean's testimony at the cited source:

"Q. [By NASD counsel]. Well, doesn't that operation in the accumulation period of VALIC appear similar to what you believe the investment companies do?

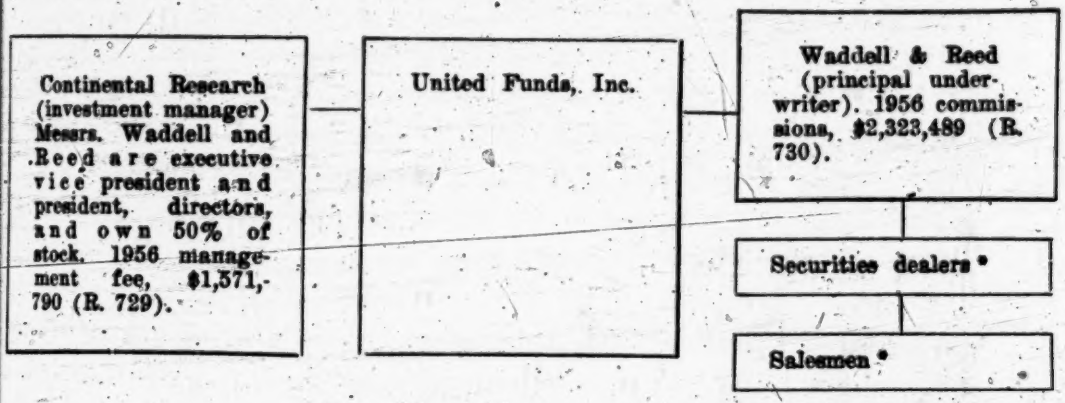
"A. Oh, no. As I understand it, it is quite different. . . . It is an entirely different thing."

NASD counsel then assumed facts not in the record:

"Q. If I told you there are investment companies which invest and reinvest your funds, would that change your answer?

"A. That would change it to this extent: that during the accumulation period, they are very similar to what happens in the Equitable Life Assurance Company or any other company, because that is what they do."

emerges, and the organization chart would look like this:



* 1956 commissions, $5,069,846 (R. 730).

The investor pays the sales organization set up by the PRINCIPAL UNDERWRITER. The UNDERWRITER deducts his commission and remits net to the FUND. The investor receives his shares as evidence of his ownership of part of the FUND, and no life contingency can or does enter into the realization of his investment. The FUND makes payment of approximately one-half per cent of total assets to the INVESTMENT MANAGER. The INVESTMENT MANAGER and the UNDERWRITER take no risk with respect to the FUND. They are independent contractors whose obligations cease at the dispensing of their services. The UNDERWRITER and the INVESTMENT MANAGER, who continue at their option and at the sufferance of the FUND, can pass out of existence as entities, and the FUND is not affected. Conversely the FUND can depreciate in value, and the INVESTMENT MANAGER and the UNDERWRITER continue to prosper. Their assets offer no benefit or protection to the fund share holder.

In contrast, the stockholders of VALIC create the capital and surplus of the company, all of which stands for the primary protection of the policyholders. All of VALIC's assets stand behind all of its liabilities.

The results of VALIC's investment of all its assets are reflected in the policy benefits. No portion of its assets are considered separately. It stands as a single entity and cannot dismiss its responsibilities until the last benefit is paid to the last living annuitant or his beneficiaries. Purchasers transact all business directly with VALIC. There are no intermediaries. Hence policyholders look solely to the Company for fulfillment of its contractual obligations.

Contractual provisions for expenses, contingencies, and company profit: In balancing the in and out flow of cash, VALIC's contracts must provide a source of funds for expenses, contingencies, and perhaps profit to stockholders. Since both SEC and NASD mislabel the policy provisions which give rise to funds for these purposes, a brief analysis is necessary.

VALIC's individual deferred life annuity policy provides that a percentage of the basic annuity premium will be applied to provide the annuity benefits. SEC (Br. 4), calls the difference "loading charges" and, in conflict with the undisputed record, mislabels it "sales expense."

All VALIC policies provide for an adjustment of gross investment results by .0015 monthly in determining the net investment rate employed to adjust reserves and annuity payments. SEC (also in conflict with the record) labels this adjustment a "management fee" (Br. 23).

A complete answer is that the provisions are unambiguous and are approved by the insurance commissioners who have authorized the sale of the policies. But that might be claimed to "assume what is sought to be proved" (SEC Br. 3 fn.), so VALIC will examine the SEC use of terminology.

An actuary calculating premiums considers the policy as a whole and must provide "the proper mar-

gins . . . to cover" all corporate requirements during the long term that the policy is in effect (R. 547). During that period, VALIC must pay all corporate expenses, all taxes,[5] all contingencies incident to possible changes in expenses[6] and mortality, and (it is hoped) some profit for stockholders. How does it obtain revenue for these inclusive corporate purposes?

Examine a hypothetical case, using VALIC's General Information and Rate Book (Pl. Ex. 2, R. 126, 579 at 619):

Assume a 35 year old male purchases a deferred life annuity providing minimum life insurance and annuity payments beginning at age 65. He also can obtain waiver of premium protection in the event of disability, but this does not appear to be under attack and may be ignored in the interest of simplification. At 65, he begins to receive annuity payments. He then has a life expectancy of something over 16 years. He dies at 81. The policy has been in force 46 years.

The $30,000 aggregate of premiums will be applied as follows:

For annuity benefits	$26,745
For life insurance benefits	105
For premium taxes (R. 244-245), average	600

[5] VALIC's Series II policies provide that taxes measured by income should be deducted in the calculation of the net investment factor (e.g., P. Ex. 1, R. 125, 567 at 573, par. 18).

Since the trial, with the approval of the Insurance Superintendent, VALIC has modified its policy by deleting the provision referring to such taxes. A copy of the endorsement which VALIC attaches to all policies is printed as Appendix IV, p. 4a.

[6] "The basic problem that inflation creates for life insurance companies is the increasing inadequacy of the expense loading on existing policies. . . . The current practice in stable times is to build up a general contingency reserve that will help to cover future costs that will not be met by the emerging expense loading." Gold, Inflation and Life Insurance (1957) TRANS. SOC. OF ACTUARIES, Vol. VIII, p. 315.

This leaves $2,550 to be applied during the 46 years the policy is in force, toward the payment of all other taxes, all sales and general corporate expenses, all contingencies, and any corporate profit. This will be supplemented (R. 546-547) by the .0015 monthly provided in the contractual provisions for determining VALIC's net investment rate.

Thus SEC attempts to compare (i) sources of revenue to meet VALIC's expenses, contingencies, and profits; with (ii) limitation on "sales load" of investment companies (1940 Act, § 27), which "sales load" pays none of the investment trust's operating expenses (SEC expert, R. 310). On this inapposite base, SEC then makes the erroneous statement that VALIC's "charges are in excess of those permitted under Section 27" (SEC Br. 29).

SEC's "speculation" argument: Similarly groundless is SEC's effort to argue that VALIC's annuity policies are or can be devices for "speculation." Here SEC coins a special definition for the word "speculation" (SEC Br. 21, fn. 13). Even this artificial definition collapses, however, when one reads the short testimony of VALIC policyholders (R. 360-374, summarized pp. 27-28, *infra*) as to their motives in purchasing their policies.

Established life insurance practice contemplates that a substantial part of the total company allowance for expenses and contingencies will be received from premiums during the early years of the policy life. It requires some eleven years for the cash value of an annual-premium fixed-dollar deferred annuity to equal the aggregate (without interest) of premiums paid, and it will take the same period for VALIC's equivalent annuity if VALIC's net investment rate averages 3½ per cent annually (D. Ex. 41, R. 537, 853, quoted in part on p. 13, *supra*). This established

industry practice makes it impractical to use a life annuity or insurance policy for "speculation," and gives important economic encouragement to the initiation and continuance of the long-range program involved in retirement planning.[1] What "speculator" would be willing to pay the premium incident to the mortality risk, which represents a substantial part of policy cost, in order to "speculate" when he can buy investment trust shares from many eager sellers without any of his payment being made for the insurance mortality guarantees?

Common sense, therefore, refutes the scare talk of "speculation." Nevertheless, VALIC considers the SEC generalizations:

Advance premiums: All insurance policies customarily provide for payment of premiums "on or before" due date (SEC expert, R. 242). VALIC will not accept advance premiums beyond the current year (R. 512). A "speculation" argument resting on the common right of a policyholder to pay an annual premium hardly merits comment.

Grace period: The District Insurance Laws require a 30 day grace period (L. I. A. § 35-705). The argu-

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[1] Income and estate taxes make unrealistic an argument that a variable annuity can be used for "speculation." Illustrations:

A gain over cost when an annuitant takes the cash surrender value of his policy is taxed as ordinary income, not as capital gain. I. R. C. § 72(e); U. S. Treas. Reg. § 1-72-11 (1956).

If a policyholder dies, any excess of the cash value of his policy over premiums paid, realized at death, will be taxed both as ordinary income and as part of his estate. Any survivor annuity is included in the gross estate at replacement cost, including "loading." I. R. C. § 2039(a); U. S. Treas. Reg. 20.2031-8, 20.2039-1. Proceeds payable to a beneficiary or to the estate are included in the gross estate. I. R. C. § 2039(a). But the survivor, beneficiary, or estate does not receive a stepped up basis for later taxation. (I. R. C. § 1014(b)(9)(A)).

ment that this period could or would be used for "speculation" merits even less comment.

Cash surrender value: State insurance laws require that insurance policies include non-forfeiture provisions. In the District, an annuity purchaser who fails to pay premiums must, as a minimum, be issued a paid-up annuity (L. I. A. § 35-705).[8] In many states, cash surrender values are required, and such a provision appears "in the vast majority" of deferred annuities (SEC expert, R. 233). In the Securities Act of 1933, § 3(a)(8) refers to the "optional annuity contract," which is merely another term for a deferred annuity policy containing the usual provision allowing an annuitant or a beneficiary to elect whether to take the cash surrender value instead of the life annuity. The provision protects the policyholder, whose personal or family needs may indicate the necessity or desirability of foregoing his retirement annuity to receive immediate funds. Since it will be years before the surrender value would equal the aggregate premiums, and since any ultimate excess will be taxed as ordinary income, there is little motivation to buy in order to cash in. There is not the slightest indication in the record that any VALIC policyholder ever intended to, attempted to, or could use the right to forfeit his annuity protection as a means of "speculation."

Loans: A VALIC policyholder may borrow on his policy only during the premium payment period, and only the lesser of total premium payments or cash sur-

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[8] NASD Br. 34 criticises VALIC because failure to pay a VALIC premium does not forfeit the purchaser's cash surrender value "as it would forfeit an insurance policy." Here NASD (i) is ignorant of the requirements of the Life Insurance Act; and (ii) is unaware of the difference between lapsing a policy (which occurs) and forfeiting the cash surrender value thereof (which under L. I. A. cannot occur).

render value: he can never borrow more than he has paid in (P. Ex. 1, R. 125, 567). The argument that one would buy for "speculation" a contract with such limitations on emergency loans is far fetched. No policyholder had ever sought a loan (R. 551).

(i) Life insurance and disability premium waiver.

Unless the applicant is uninsurable or is over 60 years of age, each VALIC individual deferred annuity policy includes life insurance (F.F. 33, R. 102). VALIC requires a minimum amount of life insurance in such cases, and offers additional insurance on various bases (F.F. 33, R. 102). An insurable individual holding an annual premium deferred annuity may, if he elects, provide for waiver of premiums to maturity in the event of total and permanent disability (F.F. 33, R. 103). As of May 31, 1957, VALIC had outstanding life insurance of $371,738 and disability premium waiver risk of $1,059,945 (F.F. 38, R. 106).[9]

(ii) Beneficiary settlement options.

Individual deferred annuity policies include beneficiary settlement options, counterparts of the types customarily offered by other life insurance companies, which permit direct settlement with beneficiaries without the necessity of going through estates (F.F. 33, R. 103).

2. Group and pension trust policies.

VALIC's three approved forms of group policies parallel group annuities offered by other life insur-

[9] The testimony of SEC's expert (R. 273-274) provides the complete answer to NASD's effort (Br. 12) to imply that there is some impropriety in the use of reinsurance by a young and growing life insurance company.

ance companies (SEC expert, R. 257-262).[10] The major portion of the annuity business in recent years has been in the group field (SEC expert, R. 257), and VALIC expects this to be true of its business (R. 507-508).

The three policies are the pension trust policy (P. Ex. 10, R. 208, 689), the deposit administration policy (P. Ex. 11, R. 209, 701), and the money or unit purchase policy (P. Ex. 12, R. 210, 713). All are described in P. Ex. 2, R. 126, 603-604. While they have different mechanical procedures and some differences of actuarial techniques, essentially they provide a choice of vehicles whereby an employer may provide an insured retirement program for his employees, with the employer's contribution as premiums and the employee's income at retirement having the benefit of the variable annuity principle.

These policies, especially the deposit administration policy, parallel the I. P. G. (Immediate Participation Guarantee Plan) policy, which for years has been issued by some of the largest life insurance companies (R. 539). Under the I. P. G. policy, the employer's premium, administered by the insurance company, is adjusted annually by the actual expenses and the actual investment experience of the insurance company, including capital gains and losses (R. 539, 560-561). The adjusted amount provides employee retirement benefits, subject to experience adjustments in the pay-out period (R. 539). SEC has never, so far as this record, SEC reports, or the SEC Briefs indicate,

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[10] VALIC notes the reference by NASD (Br. 69) to two bills introduced in Massachusetts which will authorize group variable annity policies. NASD states (Br. 68) that these bills do not relate to "insurance." The statement that group policies are not insurance will come as a shock to the insurance administrators and to the entire insurance industry.

claimed that the I. P. G. policy is a security, despite the variable payments directly dependent on investment results.

III

VALIC'S PRINTED DESCRIPTIVE MATERIAL.

All VALIC sales literature must conform to the standards set by the District/state insurance statutes and the insurance commissioners of the states where VALIC operates. As VALIC has built its business, the material naturally has evolved. SEC carefully avoids any quotations from the material relating to VALIC's current policies (D. Exs. 19, 22-27, R. 378, 745, 777-804).

An objective reading of all VALIC's sales literature, however, including P. Exs. 20 and 21 as background and 19 and 22 through 27 in use at the time of the trial, demonstrates that the basic objective of the variable annuity is retirement planning: "retirement financing" (R. 747), "retirement objectives" (R. 748), "retirement income" (R. 794, 801), "retirement purposes" (R. 757), and "retirement plan" payable for life (R. 748, 778, 782, 795). The available life annuity options and the impact upon them are fully and simply explained (R. 756, 781, 783-785). Nowhere in this material is there language indicative of security sales or an invitation to "speculation."

The trial court had no doubt as to the thrust of VALIC's activities:

> "Variable annuity policies have been designed and are intended as a means of providing a retirement program under which benefit payments tend to vary with cost of living charges" (*sic.*—Read "changes."—F.F. 29, R. 100).

This finding, not attacked, accurately epitomizes the emphasis of VALIC's sales material.

Of VALIC's sales literature, the Insurance Commissioner of the State of West Virginia very recently has stated officially:

> ". . . the defendant's operation and its sales literature have been reviewed by the Insurance Commissioner. The defendant has filed with the Insurance Commissioner all of its sales literature and other material used in West Virginia. The Insurance Commissioner has not found that this material misrepresents the terms of its policies, nor that it is deceptive nor that it constitutes an unfair trade practice as defined in Sections 3 and 4, article 11, chapter 33."[1]

Since the state insurance authorities have found that VALIC's printed descriptive materials are proper, SEC's contention that they are not proper (e.g., SEC Br. 31) illustrates the potential conflict between the two administrative authorities if SEC should succeed in this action.

There is no reasonable basis for any contention that any prospective purchaser of a VALIC deferred life annuity could have any uncertainty in his mind as to the fact that the policy provides for variable annuity payments. Each policy bears on its face in bold red type:

> "ANNUITY PAYMENTS PROVIDED BY THIS POLICY ARE VARIABLE AND ARE NOT GUARANTEED AS TO FIXED DOLLAR AMOUNT" (F.F. 35, R. 104).[2]

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[1] Brief (p. 15) of *Amicus Curiae* on behalf of C. Judson Pearson, Insurance Commissioner of the State of West Virginia, in *West Virginia ex rel. Sims, Commissioner of Securities* v. *VALIC*, pending in Circuit Court of Kanawha County, West Virginia, *supra*.

[2] Each annuity policy incorporates data from the individual's application with respect to age and sex, as well as annuity, life, and disability coverage desired. The processing of the application follows the normal routine of insurance companies (R. 504).

Each application for a policy recites in red ink immediately above the applicant's signature:

> "I understand that all dollar benefits, except any life or disability insurance benefits, provided under the policy being applied for will be variable and are subject to fluctuation by reason of the investment experience of the Company" (D. Ex. 24, R. 406, 835; see also D. Ex. 25, R. 406, 839.)

IV

TESTIMONY OF VALIC POLICYHOLDERS.

SEC called two VALIC policyholders as witnesses and then decided not to call as witnesses eight other policyholders whom it had under subpoena (R. 375). The testimony of the two policyholders who reached the witness stand was so destructive of the SEC case that SEC and NASD studiously ignore it.

The VALIC policyholders confirmed the long-range retirement, annuity income motivation of purchasers of VALIC policies. Their testimony covers only 14 pages (R. 360-374); and should be read in its entirety. It demonstrated:

1. The variable annuity was purchased as a part of an overall retirement plan (R. 361, 371).

2. The buyers understood that the contract had a total disability provision, a loan provision, and term life insurance but these "were only added enhance-

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Normally, therefore, the policy would not be completed in detail before the application is received.

Of the two policyholders called by SEC, one could not recall whether he saw his contract before he made his first premium payment (R. 366); and one stated that he did not receive the policy until "sometime after we made the application" (R. 361). From this testimony, the SEC inaccurately generalizes that "the evidence is that the purchasers did not see the contract until they had incurred the obligation" (SEC Br. 18). Of course, no policy imposes any "obligation" on the insured-annuitant.

ments to the main purpose of the contract which was for the retirement purpose" (R. 364).

3. It was understood that a portion of the premiums would accumulate to pay the annuity at the end of the contract.

4. It was understood that the purchaser had a choice of optional annuity periods, each being dependent on one or more life contingencies.

5. It was understood that the annuity benefits under the policies would vary.

6. It was understood that the annuity payments under the policy would tend to parallel changes in the cost of living, down or up.

7. It was understood that there was a risk that the amount of annuity payments would fluctuate and that the risk of such fluctuation would be borne by the policyholder.

8. A contract was desired which "would mitigate the technical obsolescence of the dollar" (Policyholder's description, R. 366).

In this connection, SEC (Br. 37) attempts to draw solace from the fact that one policyholder witness used the word "investment" (R. 362). The witness' answer shows that he was not using "investment" in a "securities" sense:

> "Well, in order to serve the purpose of completing our plans for a retirement program beyond what we had invested in life insurance, we had to make a choice as to where we would invest what money we had" (R. 362).

SUMMARY OF ARGUMENT

I

VALIC's sole business is the writing of "insurance appertaining to persons." The issue in this action is whether a variable life annuity policy falls within the "business of insurance" subject to the regulation of the state insurance authorities, or within the definition of a "security" subject to jurisdiction of SEC. The Congressional intent, manifest in the McCarran Act and the federal Securities Acts, bars dual regulation.

Insurance is a group activity dealing with "insurable risks": risks as to which (i) each insured is separately exposed, and (ii) the chance of loss is actuarially predictable.

In life insurance the only "insurable risk" is the contingency of life. Life annuities protect against the risk of longevity by pooling the contributions of the members of the group and scientifically liquidating the aggregate over the uncertain life spans of the participants.

All life insurance companies selling life annuity policies make investments in media permissible under state insurance statutes and state insurance regulation. All such investments involve some risk. This "investment risk" fails to meet the distinguishing tests of an "insurable risk," *supra.* In every mutual company, and in every stock company (subject to the cushion of stockholder capital and surplus), this "investment risk" falls on the policyholders.

For nearly half a century, life insurance companies have been conscious of, and concerned with, the necessity of providing in their policies a measure of protection which would tend to keep pace with the cost of living. At least as early as 1935, American life insurance companies were issuing policies which, in every conceptual essential, were variable life annuities.

The variable life annuity issued by VALIC and other life insurance companies under state insurance laws and state insurance supervision differs from the fixed-dollar life annuity only in that it affords a contractually precise method of adjusting reserves and annuity benefits to the company's investment experience. The variable life annuity is an insurance policy, and in offering it VALIC is engaged in the business of "insurance appertaining to persons."

II

The McCarran-Ferguson Insurance Regulation Act excludes the SEC from regulatory jurisdiction over VALIC. Prior to 1944 the states for 86 years had been active in the regulation of the business of insurance. The *South-Eastern Underwriters* case, 322 U. S. 533 declared the business of insurance to be interstate commerce. Shortly thereafter Congress passed the McCarran Act pursuant to its legislative judgment "that the continued regulation and taxation by the several states of the business of insurance is in the public interest."

The McCarran Act restored to the states, unless Congress should legislate specifically on the subject, priority in the regulation of the business of insurance. This regulation included state supervision of the organizational structure of the company, the types of insurance coverages it could offer, the form of such policies, including the method employed to determine, measure and express the amount of the insurer's liability, and the media of investments lawful for the insurance company's funds.

To impose on VALIC the regulatory scheme of the 1933 Act and the 1940 Act would supersede, impair, and invalidate state insurance laws under which VALIC is authorized to operate. As a conspicuous

example, provisions of the 1940 Act would make it legally impossible for VALIC to sell the very policies here involved, which have been approved, under District/state insurance law, by District/state insurance authorities.

The Life Insurance Act of the District of Columbia, administered through the Insurance Superintendent, affords the fullest protection to the public. Where a company, as does VALIC, operates outside the District, the states in which it is authorized to do business also regulate its activities.

III

VALIC does not sell "securities" within the purview of the 1933 Act. The variable life annuity policy is not a "security." It affords to the annuitant an income determined by his age and sex, and terminating on death.

The factor which distinguishes a life insurance annuity from a "security" is the group sharing of the risk of longevity. This essential distinction is not dependent upon an expression of minimum payments in fixed-dollar amounts, or upon the media in which the insurance company may elect, subject to the controlling insurance statutes, to invest. The distinction is clear and self-evident: those who die early receive income for a short time, and those who live long receive payments until death. No "security" has any such feature (SEC's "securities" experts, R. 306, 395, 404).

The 1933 Act exempts from registration "any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner . . . of any State or . . . the District of Columbia." VALIC's life annuity policies fall squarely within this provision, and the intent of Congress to exclude such insurance contracts from registration with SEC could not be more clearly expressed.

IV

VALIC is not an "investment company" within the purview of the 1940 Act. In addition to the requirement that an "investment company" be an issuer of "securities," legislative history demonstrates that Congress in 1940 was not seeking to impose dual regulation on insurance companies. Committee reports and Congressional debates confirm that it was the intent of the 1940 Act not to impose federal regulation on life insurance companies.

The Act specifically declares that, "notwithstanding" the sweeping language of its definitional section, an insurance company is not "an investment company within the meaning of" the Act (Sec. 3(c)(3).

VALIC is an "insurance company" as defined in and excluded from such Act: It is organized as an insurance company. Its sole—and clearly its "primary and predominant"—business activity is the writing of life insurance, disability, and variable annuity policies, all of which are integral parts of the business of insurance. It is subject to supervision by the District/state insurance commissioners in the District and in each state where it operates.

ARGUMENT

I

VALIC'S SOLE BUSINESS IS THE SALE OF "INSURANCE APPERTAINING TO PERSONS."

VALIC's sole charter authority is "to engage in the Life Insurance business, writing life insurance, disability insurance, and variable annuities in combination policies . . . written appertaining to persons as such business is now or may hereafter be regulated by the . . . 'Life Insurance Act' " (D. Ex. 3, 8, R. 406, 814, 817).

A. VALIC'S POLICIES EFFECTUATE THE TRADITIONAL FUNCTION OF THE BUSINESS OF LIFE INSURANCE

1. Concepts: "investment," "securities," "insurance."

This case involves three concepts which for clarity must be kept distinct: (a) "investment," as the savings program of the individual; (b) "insurance appertaining to persons"; and (c) "securities" as defined in the 1933, 1934 and 1940 Acts.

2. "Investment": The care of surplus funds.

In his savings plan, one "invests" by converting a portion of his transient income into some form of wealth other than money, with the intent that he, his family, beneficiaries, heirs, or estate will at some future date enjoy benefits which this investment will procure. The field of "investment" is as broad as the instrumentalities available for one's surplus funds. Initially one usually buys life insurance. Said SEC in 1940:

> "Life insurance provides the channel through which millions of American people accumulate savings to gain for themselves and their family a larger measure of security . . ."[3]

In 1957, 121,000,000 Americans owned $500 billion of such family "securities".[4] After life insurance came a home and then savings find a variety of outlets—whether in life insurance annuities, interest bearing deposits, government or corporate securities, works of art, or other available means for preserving value.

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[3] SEC Report, "Study of Legal Reserve Life Insurance Companies," TNEC MONOGRAPH 28, p. 1. This Report was prepared by SEC between July 7, 1938 and July 22, 1940, the date it was transmitted to the Temporary National Economic Committee by Sumner T. Pike, then an SEC Commissioner. It will be cited as "TNEC MON. 28."

[4] 1958 LIFE INSURANCE FACT BOOK, p. 7.

The issue here, therefore, is not "insurance" versus "investment" (cf. SEC Br. 3 fn). It is "insurance appertaining to persons", under the District and state insurance laws versus "security" as defined in the 1933 Act, the Securities and Exchange Act of 1934, and the 1940 Act.[5]

3. "Insurance appertaining to persons."

a. The nature of "insurable risk."

The essence of any insurance operation is the shifting and distribution of an "insurable risk." To be insurable, a risk must meet two conditions (R. 460):[6]

(i) It must involve a fortuitous hazard to which the insured individual is separately vulnerable, so that if the peril strikes, the impact falls on the individual and can be absorbed by the insurer and spread among the group of unscathed policyholders; and

(ii) It must be actuarially predictable, so that it can become the subject of scientific group distribution.

b. The function of insurance "appertaining to persons."

The insurable risk in life insurance is the uncertainty as to the time of death. Life insurance companies protect against the financial consequences of (i) death, and conversely, (ii) longevity (P. Ex. 22, R. 778; SEC expert, R. 219-220). Though actuaries can not foresee how long any individual will live, they can forecast, on the basis of statistical data accumulated in mortality tables, the average lifetimes of groups (R.

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[5] Congress has exercised care to define "security" in numerous other statutes: e.g. 16 U.S.C. § 796(16) (Federal Power Act); 11 U.S.C. § 402 (bankruptcy); 11 U.S.C. § 205(b) (railroad reorganizations); 11 U.S.C. § 506 (corporate reorganization); 18 U.S.C. § 2311 (crimes); etc.

[6] For these reasons an insurance company's "investment risk" is not an "insurable risk".

254-257, 456-457). Investment companies, of course, "don't use mortality tables at all" (SEC expert, R. 322).[7]

With life insurance, the risk insured arises from early death. Premiums are calculated to bring in an aggregate capital fund from all insured persons sufficient (after expenses) to provide for losses on early deaths, making allowance for investment earnings and for "mortality gains" from premiums paid by those who outlive their normal life expectancies.

With annuities, the risk insured arises from longevity (cf. SEC expert, R. 220). Premiums are calculated to bring in an aggregate capital fund sufficient (after expenses) to provide for losses on longevity, making allowance for investment earnings and for "mortality gains" from termination of annuity payments to those who die early (R. 458).[8]

Thus the distinguishing characteristic of contracts issued by life insurance companies is the shifting and distributing of mortality risks (R. 220, 478). The actuarial considerations which must control this type of risk shifting and distribution with the use of mortality tables are within the traditional function and technical competence of life insurance companies. The variable annuity, involving this risk shifting and distribution, is "purely an insurance operation" (R. 485).

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[7] In attempting to analyze VALIC's deferred annuity policy, SEC found it necessary to call a life insurance actuary—Hooker—since their "securities" experts frankly acknowledged that they were not competent to discuss the policy (R. 321).

[8] This case is concerned with the sale of life annuity policies to the public by a life insurance company. It is unnecessary to discuss NASD's reference (Br. 37) to marriage, partnership, and other arrangements, wholly irrelevant to the insurance concept, which are used by individuals dealing with their own affairs.

c. The "investment risk" in life insurance operations.

SEC's case rests on its notion that what SEC calls the "investment risk" falls on VALIC's policyholders in a manner or to an extent fundamentally different from the manner in which it falls on policyholders of other life insurance companies.

Life insurance contracts usually involve an "investment element" (SEC expert, R. 263).[9] In the deferred annuity, net premiums build up over the years an aggregate of assets for the payment of annuity benefits. Thus every life insurance company comes to have funds which, as an incident to its insurance function, it invests in media authorized by state insurance statutes. By its nature, every such investment involves risk.

In all life insurance companies, the risk of adverse investment results falls solely or predominantly on the policyholders. It falls solely on them in the mutual company (R. 470-471, 473; SEC expert, R. 298), for they are "both the insurers and the insured". *Hutchins Mutual Ins. Co.* v. *Hazen,* 70 App. D. C. 174, 105 F. 2d 53, 57 (1939). Through dividends, or lack of them, the policyholders benefit from favorable, and suffer from unfavorable, investment, mortality, and expense results (SEC expert, R. 225; R. 470). In a stock company, the risk falls upon the policyholder also, subject to the cushion supplied by the stockholders' capital and surplus (R. 472).[10]

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[9] KRUEGER AND WAGGONER, THE LIFE INSURANCE POLICY CONTRACT (1953 ed.) 194, quoted *United States* v. *Bess,* 357 U.S. 51, 58 (1958).

[10] In 1957 the $683,000,000 aggregate capital of United States stock life insurance companies was less than .004 of the $178,500,000,000 of their outstanding insurance. 1958 LIFE INSURANCE FACT BOOK, pp. 15, 62. The reference does not state separately the surplus attributable to stock companies.

Moreover, under severely adverse conditions, the nominal amount of premium affords no ceiling on the cost of life insurance. While premiums remain unchanged, the available surplus is reduced (R. 471), and if results continue to be adverse the non-forfeiture portions of the policy are reduced by subjecting them to a lien.'"[1]

In life insurance, therefore, protection against adverse investment results does not rest upon the nature of the contract. The indisputable fact is that no life insurance or life annuity policy can or does shift the "investment risk." That is not an "insurable risk," since adverse results cannot fall upon the individual policyholder and so cannot be shifted to and shared by other policyholders who otherwise would have escaped the impact of the risk (R. 460).[2] The policyholder's

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[1] During the 1930's 39 life insurance companies discontinued operations with losses to policyholders (TNEC Mon. 28, p. 101-102). Nineteen discontinuances resulted in a total indicated initial loss to policyholders of over $138,000,000 (id. pp. 131-32). Liens in this amount, aggregating 57.4 per cent of net reserves on the policies, ranged from 50 per cent of net reserves in 9 companies to 100 per cent in 4 companies (ibid).

NASD Br. p. 37, fn. 1, extols what it calls the "common knowledge" of the liquidity of life insurance during these years, when (NASD claims) it paid all losses, cash values and loan values. Such "common knowledge" fades before the facts in TNEC Mon. 28.

[2] Among numerous errors in the SEC Brief is the statement (SEC Br. 35) that VALIC's "expert testified, the variable annuity cannot insure against this investment risk." The witness gave no such testimony. The source cited by SEC, R. 460, is correctly stated in the VALIC text above.

NASD raises the spectre of economic collapse so catastrophic that between the first monthly annuity payment and the second, VALIC's assets would be reduced to zero. Only that contingency could support NASD's statement, repeated four times in one paragraph (NASD Br. 9-10), that VALIC's contractual obligation

assurance rests primarily on three factors, none of which would be strengthened by superimposing the regulation of SEC:

i. The state statutes which, in every jurisdiction, fix the tests of investments deemed by the legislative body to be suitable for life insurance companies.

There is no restriction on the investments of any other District life insurance company which is not equally applicable to VALIC.[3] VALIC can invest only in media satisfying the requirements established by Congress in L.I.A. § 35-535 (F.F. 39, R. 106).[4] One class of investment authorized is the common stock of a company which has paid cash dividends on such common stock for the five years preceding purchase, provided that: (a) if the company has outstanding bonds or other evidences of indebtedness, interest must have been earned 1½ times for the last fiscal year and

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to an annuitant does not obligate it to make any payment after the first.

Contrast the testimony of SEC's expert that, assuming VALIC's solvency under the regulation of the District Insurance Superintendent, its policies provide the annuitants an income for life (R. 281-2).

[3] SEC's argument that it should regulate VALIC because SEC thinks that "the chance of spectacular success through speculative investment might sometimes outweigh considerations of safety" (SEC Br. 51) should be contrasted with its criticism of VALIC for the conservative investment policy the company was following at the time of trial (SEC Br. 18 fn). If SEC's argument had any merit, it would provide a lever for SEC to regulate all life insurance companies.

[4] The quality and diversification of an insurer's investments required by L.I.A. § 35-535, *supra*, may be compared with SEC Br. 28 reference to the provisions of the 1940 Act that "management" of the investment trust adopt a "fundamental investment policy" which can be changed only by "vote of its security holders." Query: does this afford protection comparable to a fundamental investment policy set, and changeable only by, Congress?

averaged 1½ times yearly for the preceding five years; (b) if it has outstanding preferred stock, preferred dividends must have been earned three times over during each of the three preceding fiscal years; and (c) not over 1 percent of the life insurer's admitted assets may be invested in the common stock of any one corporation.

ii. The ability and the integrity of the management.

No claim is or can be made on this record that the management and advisors of VALIC are not fully qualified, by experience, training and integrity, to operate the company in the interest of its policyholders.

iii. The constant, continuous, detailed supervision of the insurance superintendent and his staff.

The pervasive scope of this supervision goes so far beyond that of SEC in the "security" field that it sustains the comment that

> "the business of insurance has been more generally regulated than any other sphere of business activity not a public utility." *American Hospital & Life Ins. Co.* v. *F.T.C.*, 243 F. 2d 719 (5th Cir. 1957), aff'd per curiam, *Federal Trade Commission* v. *National Casualty Co.*, 357 U.S. 560 (1958).

B. VALIC'S POLICIES INCORPORATE PROTECTIONS WHICH EMBODY STUDIES AND PLANS OF THE LIFE INSURANCE INDUSTRY SPANNING FOUR DECADES

Congress did not petrify the insurance business when it enacted the 1933 Act. District and state insurance laws then required, and still require, that new policy forms be approved by the insurance authorities before they may be offered. Aside from statutory clauses, there are no standard forms. Insurers design and seek approval of contracts offering new forms of insurance service and protection as needs therefor are discerned (SEC expert, R. 227. Conceded, NASD Br. 39). As NASD says (Br. 38): "What a state, in the exercise

of its sovereign power, may choose to encompass within a statutory definition of the term 'insurance' need not be confined to the 'commonly accepted sense' of the term."

> "It has been estimated that more than half of all life insurance in force today represents uses of insurance protection which have either been introduced or received their major development in the past 25 years. Included are the family income plans, . . . retirement income insurance . . ."[5]

For at least forty years the life insurance industry has been conscious of the necessity of developing insurance techniques designed—in the words of one VALIC policyholder—to mitigate the "technical obsolescence" (R. 366) of fixed-dollar annuities.[6] To

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[5] 1956 LIFE INSURANCE FACT BOOK, Ct. Ex. 1, p. 12. Writing in 1958, Huebner found it necessary to make a "thorough revision" of his 1950 edition. "Recent years have seen tremendous changes in the life insurance business." HUEBNER and BLACK LIFE INSURANCE (5th ed. 1958), p. vii.

[6] In terms of a retirement policy covering 30 years of premiums, the real value (i.e., the purchasing power) of fixed-dollar annuities has suffered ruinous erosion (R. 412-4, 482; D. Ex. 30, R. 406, 841):

Inception Date	Inception Goal in Purchasing Power	Maturity Date	Maturity Purchasing Power
1880	$100.00	1910	$80.40
1890	100.00	1920	38.40
1900	100.00	1930	47.40
1910	100.00	1940	67.70
1920	100.00	1950	83.50
1930	100.00	1960	(?).
1940	100.00	1970	(?)

(Source: Bureau of Labor Statistics Cost of Living Index of all items for moderate income families in large cities D. Ex. 30, R. 841).

accomplish this, it was necessary to develop a means of expressing the company's policy liability in a measure keyed to the media available for investment of the company's assets.[7]

The problem was emerging before World War I.[8] But the ensuing years brought it into focus. In Germany before the drastic currency reforms of 1924, life insurance companies, trying to stabilize the insured's protection, issued policies payable in American dollars, rye and coal.[9] Use of these commodities as "policy money" was feasible because there were available at the time in Germany government bonds and debentures expressed in rye and coal.[10]

At the International Congress of Actuaries in London in 1927, attention was given to the problem (R. 481). Thirteen speakers, from ten countries, delivered papers upon the general subject of "currency depreciation as affecting life assurance contracts."[11] One important paper pointed out that an insurance company offering only protection in dollars or pounds can stand financially indifferent to inflation.

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[7] See Sir Joseph Burn, Address by the President, 8th International Congress of Actuaries, 59 JOUR. INST. ACTUARIES (London, 1928), Pt. 1, p. 19; Recknell, Insurance Against Inflation, TRAN. FACULTY OF ACTUARIES (1949) Vol. 19, Pt. 1, p. 23.

[8] Westergaard, Currency Depreciation as Affecting Life Assurance Contracts, TRANS. 8th INTERNATIONAL CONGRESS OF ACTUARIES (1927) Vol. II, p. 255, 259.

[9] Westergaard, *supra*. See also Recknell, *supra*. In Austria, policies also were expressed in United States dollars or in gold. Wollner, The Effect of Currency Depreciation . . . in . . . Austria, TRANS. 8th INTERNATIONAL CONGRESS, *supra*, p. 247.

[10] Gold, Inflation and Life Insurance, TRAN. SOC. OF ACTUARIES (1957) Vol. VIII, p. 315, 322.

[11] TRANS. 8th INTERNATIONAL CONGRESS OF ACTUARIES (1927) VOL. II, pp. 247-307.

"But . . . it is not indifferent to the policyholder, when his claim is due, to receive only a fraction of the purchasing power which he intended to acquire. . . .

"So long as money has a varying purchasing power there is thus . . . a vast field for progress in life assurance. . . . So far as I can see, the problem of stabilizing the sums assured [in terms of purchasing power] is the most important problem with which modern life assurance has to deal, and there is a vast field for real progress."[2]

In the early 1930's, with purchases of individual life annuities at a high level, American life insurance companies encountered two problems: mortality tables which did not reflect accurately the increasing longevity of annuitants; and unfavorable investment results due to declining returns on their investments.[3] Through cooperative studies, new mortality tables were developed to adjust for increased longevity. Of the investment rate, SEC said in 1940:

"A special problem was posed in the determination of the proper interest assumption for the annual premium retirement annuity involving as it did the investment (*sic*) of small sums over a long period of time as in the case of the life insurance contract. In an effort to solve the difficulties, more conservative interest assumptions were adopted."[4]

Then comes the emergence of all elements of the variable annuity. Reported SEC:

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[2] Westergaard, *supra*. See also Burns, *supra*. The same fact was expressed in Raynes, The Place of Ordinary Stocks . . . in the Investment of Life Assurance Funds, JOUR. INSTITUTE OF ACTUARIES (1928) Vol. 59. Pt. 1, p. 21.

[3] TNEC Mon. 28, p. 332.

[4] Ibid.

"Some companies substituted participating retirement annuities for the nonparticipating contracts which had been based on higher guaranteed rates and, in a few instances, the nonparticipating single premium immediate annuities were replaced by similar contracts on a participating basis. . . . [A] . . . but a few companies—including the two largest in point of individual annuity business, the New York Life and the Equitable of New York—adopted the participating forms."[5]

These contracts, put into effect January 1, 1935,[6] manifestly were variable annuities (though not until later was the term in common use). As the SEC expert explained, a "participating policy is a policy which, according to its terms, shares in the [di]visible surplus by the company" (R. 284). Both the companies and the SEC recognized that premiums and annuity payments would vary. The assumed investment return was sufficiently low to eliminate any reasonable possibility that the company's results could fail to exceed it,[7] and participation was substituted to permit the annuitant to share in dividends reflecting investment experience, mortality gains, and expense savings (SEC expert, R. 284):[8] in the premium payment period by using dividends to reduce the premium or to increase the accumulated cash value for the annu-

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[5] TNEC Mon. 28, p. 332.

[6] Id. p. 333

[7] Some companies selling fixed-dollar annuities today base their minimum obligations on a 2 per cent investment rate (R. 497). In the 43 years 1915-1957 inclusive, the investment income rate of United States life insurance companies has never been below 2.88 per cent (1947), has been below 3 per cent in only three years. 1958 LIFE INSURANCE FACT BOOK, p. 59.

[8] The "dividend" on such a participating annuity policy "is relative to problematical earnings and not absolute to the payment of fixed sums." *Herman* v. *Mutual Life Ins. Co.*, 108 F. 2d 678, 681 (3d Cir. 1939).

ity; in the annuity payment period by adding dividends to the minimum payments. The policyholder under such a contract shares in the investment results of the company in the same manner that the owner of the variable annuity does (R. 473).

> "Under participating annuity policy contracts, the amount of the payment to the annuitant may vary . . . arising from experience more favorable than anticipated. . . . Plaintiff SEC does not contend, neither has it shown, that it has ever instituted any legal or administrative action charging that annuity policies payable in fixed-dollar amounts issued on a participating basis are 'securities' . . . , or that the insurance companies issuing such policies are 'investment companies' under the . . . Act of 1940" (F.F. 28, R. 100).

It soon was obvious, however, that this embryonic form of variable annuity based on participating policies could not keep pace with changes in the cost of living.

The next essential step was a broader statutory classification of investments legal for life insurance funds. Again SEC lent its prestige. In what SEC itself described as "in many respects the most significant section,"[9] its TNEC report criticized life insurance investment practices and summoned the insurance companies "to find methods by which the funds flowing under their control will become available as equity . . . and by which investments in common stocks will become more prevalent."[10]

This Report stimulated wide public discussion, followed in 1941 by publication of "Statement on Life Insurance," TNEC Monograph 28-A. This mono-

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[9] TNEC Mon. 28, p. 3.

[10] Id. at p. 378.

graph published the comments of certain insurance companies, and the "Rejoinder" of SEC Commissioner Pike and his senior staff assistant. Two aspects of this Rejoinder are significant in the context of this litigation.

First, it emphasized:

> ". . . The recommendations on the common stock question were contained in suggestions for State legislation and it was specifically pointed out that the recommendations in no way directly or indirectly, were intended to suggest that the Federal Government exercise authority over the investments of life insurance companies."[1]

Secondly, the Commissioner transmitted for the record a copy of a 1939 address by Dwight C. Rose, president of the Investment Counsel Association of America, made to the American Life Convention, entitled "The Policyholders' Interest in Equity Investments."[2]

Rose's address, printed in full in TNEC Monograph 28-A, urged a wider use of common stocks as outlets for life insurance funds. He warned, however, that "From the policyholder's standpoint . . . the inclusion of a small equity participation in life insurance reserve funds, against the regular 'dollar' policies now issued, would do little toward solving the basic problem of 'purchasing power' protection."[3] He therefore proposed that life insurance companies issue "equity policies" under which the:

> "dollar value of premium, face amount, or cash surrender, would of course vary from time to time

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[1] TNEC Mon. 28-A, p. 25.

[2] Id. at p. 26.

[3] Id. at p. 53.

with the changing dollar value of the equity fund.'"[4]

During the 1940's state statutes governing the investments of life insurance companies were amended so as to increase the eligibility of common stocks. Today in over two-thirds of the states, statutes specifically authorize investments by life insurance companies in common stock within differing limits. At the close of 1957 United States life insurance companies owned some 1.87 billion of common stocks.[5] Subject to the supervision of the respective state insurance authorities, at least seven states and the District of Columbia do not limit, by percentage or other formula, the amount which domestic life insurance companies may invest in common stocks meeting prescribed statutory standards.[6]

All the elements were now available to permit the life insurance companies to bring to fruition the trend which had been initiated three decades before.

The "economic premise" of variable annuities "is derived from historical studies relating to substantial long-term correlation in the movement of (i) average market prices of a selection of common stocks, and (ii) cost of living indices" (F.F. 29, R. 100).[7] After

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[4] Ibid.

[5] 1958 LIFE INS. FACT BOOK, p. 91. In addition, the companies held 1.5 billion in preferred stocks.

The Wall Street Journal, December 16, 1958, p. 23, reported that in the first 49 weeks of 1958, 33 major life insurance companies invested $152,467,234 in common stocks.

[6] Arizona, Arkansas, Connecticut, District of Columbia, Georgia, Louisiana, New Hampshire, and New Jersey. The District standards for common stock investments (L.I.A. § 35-535) are stated at p. *supra*.

[7] The validity of this premise has been confirmed by the Prudential Insurance Company in tests of hundreds of historical

twenty-odd years of discussion, actuaries were saying that "The time has come for us seriously to consider the possibility of devising some means of mitigating for our policyholders the evil results of fluctuations in the purchasing power of the eventual proceeds of their policies."[8] In 1950 Teachers Insurance and Annuity Association ("TIAA"), a legal reserve life insurance company selling annuities to college staff members, made exhaustive economic, actuarial, and legal studies which established the soundness of variable annuities as an instrument of retirement planning (R. 483).

College Retirement Equities Fund ("CREF"), a companion company under joint management with TIAA, was incorporated in 1952 by Laws—New York 1952, c. 124, which subjected it to regulatory provisions of the New York Insurance Law.[9] Under the supervision of the New York state insurance authorities, CREF offers to educational personnel variable annuities supported by reserves invested in equities, with benefits reported in terms of accumulation units and annuity units. At the end of 1956, CREF variable annuities covered 31,156 individuals; its net assets were $39,817,951; and its annuity unit, which in July, 1952, was attributed a dollar valuation of $10, had a valuation of $18.51 (D. Ex. 36, R. 847). Maclean, one

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situations (R. 415). The results are shown graphically in D. Exs. 31, 32, 33, and 34, R. 424, 426, 427, 429, 842-845. They are explained in detail by Prudential's Director of Economic and Investment Research at R. 418-433.

[8] Recknell, Insurance Against Inflation, TRAN. FACULTY OF ACTUARIES (1949) Vol. XIX, Pt. 1, p. 17.

[9] Among other things, CREF's constitution and by-laws, its forms of contracts, and its rules for determining annuity benefits must be approved by the Superintendent of Insurance of New York. CREF reports annually to the Superintendent of Insurance of New York. It is "effectually within the control of the Superintendent" (R. 485).

of the outstanding authorities on life insurance, and a trustee of TIAA who was directly concerned with the development of CREF, characterized CREF as "the best example of a pure insurance arrangement that you can have . . . [I]t is purely an insurance operation" (R. 480, 485).[10]

Continued study during the 1950's of means of bringing the protections afforded by life insurance and life annuities into closer harmony with changes in the cost of living is reflected in reports of numerous addresses and conferences at meetings of representatives of life insurance companies.[1]

Meantime, of course, CREF had shown the practical route to a broader base of insurance protection. With the CREF example in mind, life insurance companies were organized with authority to offer variable life annuities. The first life insurance company to offer variable annuities to the general public was Participating Annuity Life Insurance Company, formed by professors associated with the University of Arkansas, which has been selling variable life annuity policies under the supervision of the insurance authorities of Arkansas—and without attack from SEC—since 1954. VALIC followed in 1955 and EALIC in 1956.[2]

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[10] Characteristic of its approach, NASD asserts flatly that CREF is one of "pension plans, which are not insurance" (Br. 68-9).

[1] See TRANSACTIONS, 14th INTERNATIONAL CONGRESS ACTUARIES, Vol. II for numerous papers dealing with the effect of inflation on life insurance. See also: Gold, Inflation and Life Insurance (1956 Annual Meeting) TRANS. SOC. ACTUARIES, Vol. VIII, p. 315; Insurance Contracts in Terms of Equity Shares, Session Nov. 25, 1957, JOUR. OF INST. OF ACTUARIES, Vol. 84, pt. 1, p. 37 (1958); Junnilo, The Methods Taken by Finnish Life Assurance Companies to Protect Life Assurance Against Inflation (Helsinki, 1958).

[2] NASD's statement (Br. 5) that VALIC and EALIC were "first" is factually incorrect.

Variable annuities, as a part of the state's retirement program for teachers and certain municipal and state employees, were provided by Wisconsin Laws 1957, chs. 322, 381, and 423, which put into effect a report and recommendations of the Governor's Retirement Study Commission.

Within the past several weeks there has been filed with SEC a registration statement covering $7,500,000 of common stock of the Government Employees Variable Annuity Life Insurance Company, a life insurance company chartered under District law, which has announced that it will offer variable annuity policies.

From the post-World War I policies issued in terms of coal and rye, through the increasing recognition of index-clauses and the stabilizing effect of equity investments, to the carefully considered development of the variable annuity, runs a steady evolutionary development in the life insurance technique. No one suggests, least of all VALIC, that the variable annuity is the final answer: it submits, however, that it is the best thus far evolved from nearly half a century of study within the life insurance industry.

II

THE McCARRAN-FERGUSON INSURANCE REGULATION ACT EXCLUDES THE SEC FROM REGULATORY JURISDICTION OVER VALIC

The McCarran Act declares "that the continued regulation and taxation by the several States of the business of insurance is in the public interest." McCarran Act preamble, 15 U.S.C. § 1011.[3] The trial court and the Court of Appeals correctly held that the regulation of VALIC's business and its contracts is vested in the District and the State insurance authorities.

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[3] The McCarran Act, § 5, includes the District of Columbia in its definition of "State".

A. BACKGROUND OF THE McCARRAN ACT

Following *Paul* v. *Virginia*, 75 U.S. (8 Wall.) 168 (1868), the insurance business until 1944 was held not to be "commerce";[1] Congress did not attempt to regulate it; and the states developed comprehensive regulatory and taxing systems. *Prudential Ins. Co.* v. *Benjamin*, 328 U.S 408, 415-417 (1946). Under their police power, the states have ample power to protect from fraud, incompetence, misrepresentation, and sharp practice in the business of insurance. *Robertson* v. *California*, 328 U.S. 440 (1946); *Travelers Health Ass'n.* v. *Virginia, ex rel. State Corporation Commission*, 339 U.S. 643 (1950). Of State regulation, Mr. Justice Jackson stated (322 U.S. at 590):

> "Such state departments, through trial and error, have accumulated that body of institutional experience and wisdom so indispensable to good administration."

United States v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), declared the business of insurance conducted across state lines to be interstate commerce. The decision raised serious questions: one dissent stated that it would require "a generation of litigation" to define the respective areas of federal and state regulation.[2] Federal regulatory statutes of general application had not been drafted with the thought or intent that they should be applied to insurance. Their attempted application would have induced dislocations and conflicts.

This is illustrated by the present action. The potential confusions, if both State insurance commissioners

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[1] See for example, *New York Life Ins. Co.* v. *Deer Lodge County*, 231 U.S. 495 (1913); *Hooper* v. *California*, 155 U.S. 648 (1895). Other cases are cited in *United States* v. *South-Eastern Underwriters Ass'n, supra*, 322 U.S. 544, n. 18.

[2] 322 U.S. at 590.

and SEC undertake supervision of VALIC's business and policies, have been understated: "It is probable" —VALIC would say it is certain—"that in the regulation of the business of insurance by both the federal and state governments there will develop a conflict of policies . . . [I]n such event the federal regulation would control. If so, 'the continued regulation and taxation by the several states,' referred to in . . . the [McCarran] Act as being in the public interest, would no longer exist." *National Casualty Co.* v. *FTC, supra,* 245 F. 2d at 883, aff'd *Federal Trade Commission* v. *National Casualty Co.,* 357 U.S. 560 (1958).

An SEC expert, a former commissioner of the SEC, declared that if a variable life annuity policy were held to be a "security" under the 1933 Act, "it is possible" that "if the variable annuity is issued by an insurance company acting in pursuance of the regulations of an insurance commission of a state, that immediately upon its issuance it would become in conflict between state and federal laws" (R. 402).

The effort of SEC to strain VALIC into the "investment company" category illustrates this conflict. SEC contends that VALIC is a management company under § 4 (3) of the 1940 Act.[6] The Act divides "management companies" into "open-end" and "closed-end" companies, id. § 5(a).[7]

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[6] SEC has never contended that VALIC is a "face-amount certificate company" (1940 Act, § 4(1)). Count Three of the SEC Complaint may have been intended to charge that VALIC is a "unit investment trust" (id. § 4(2)), but that Count has been explicitly abandoned (SEC Ct. App. Br. 3, fn. 3).

[7] Congress' intent to fix, and limit, the possible classification of "management companies" is unquestionable. Congress deleted from S.B. 3580 a section (§5(d)) which would have granted SEC authority "to make further classifications and subclassifications of investment companies."

Accept SEC's contentions and it follows:

1. If VALIC were an open-end investment company it would be unlawful for it to "issue any class of senior security." 1940 Act, § 18(f). VALIC's variable annuity policies constitute a claim on all its assets senior to the rights of VALIC's stockholders (SEC expert, R. 296): if they were "senior securities" they would be flatly prohibited.

2. If VALIC were a closed-end investment company it would be unlawful for it to issue a "senior security representing indebtedness" unless it had an asset coverage of 300 per cent; or a senior "stock" unless it had coverage of 200 per cent. 1940 Act, § 18(a)(1)(A) and (2) (A). Such asset coverages on insurance policies would be utterly impossible.

SEC does not say which section it would seek to apply, but either alternative would bar VALIC from offering the very policies which the Insurance Superintendent has approved.

The destruction of VALIC which would follow from these statutory provisions was pointed out in both courts below. SEC in the Court of Appeals conceded that "if the injunction were granted on this ground [i.e., 1940 Act, § 7(a)] it would effectively prevent the appellees from engaging in any of the activities alleged in the complaint" (SEC Ct. App. Br. 3, fn. 3). In this Court, SEC is somewhat less frank. It seems to suggest that VALIC might survive,

> "even though the respondents would have to alter their structure and the provisions of their present contracts to comply with some of the Act's provisions" (SEC Br. 54).

But by these cryptic words SEC admits that its claims here, if upheld, would invalidate, impair and supersede the insurance laws of the District and the states under which VALIC operates.

What SEC means by the language "alter their structure" may be clarified by a letter of SEC, dated December 24, 1958, with respect to the prospectus for an underwriting of stock for another variable annuity life insurance company referred to p. 49, *supra*. SEC, with respect to the present appeal pending in this Court, states:

> ". . . should the Court uphold the contention that these Acts are applicable to companies issuing variable annuity contracts, the registrant would be an unregistered investment company and all sales and contracts previously made by the company would be in violation of the Acts and therefore void . . . If liquidation of the registrant would be a possible result of such decision, this should be made clear, including a discussion of the liquidation rights of the stockholders."

(Source: Government Employees Variable Annuity Life Insurance Company, SEC File No. 2-14535, letter by Charles H. Eisenhart, Assistant Director, Division of Corporation Finance, December 24, 1958, pages 1, 6).

SEC thus would seem to fully substantiate VALIC's contention that if VALIC were subjected to the 1940 Act, its policies would be invalidated and its entire business destroyed. This would not be regulation but sheer annihilation. Surely the Congress, which enacted the L.I.A., the 1940 Act and the McCarran Act never contemplated or envisioned such a catastrophic result.

B. PURPOSE OF THE McCARRAN ACT

In the first session of the 78th Congress, in 1943, S. 1362, H. 3269, and H. 3270 were introduced prior to, but in anticipation of, *South-Eastern Underwriters, supra.* These bills contained one paragraph to exclude the business of insurance only from the Sherman and Clayton Acts. The narrow scope of these early bills lends added significance to the broad and carefully integrated provisions of the final Act, and provides a conclusive rebuttal to SEC's argument (Br. 57) that in this Act the purpose of Congress was "limited [to] the suspension [of] the class of regulation which had thrown the insurance companies into confusion", i.e., "the antitrust laws" (SEC Br. 15).

Congress intended by the McCarran Act:

> ". . . broadly to give support to the existing and future state systems for regulating and taxing the business of insurance . . .
>
> ". . . Congress must have had full knowledge of the nation-wide existence of state systems of regulation and taxation; of the fact that they differ greatly in the scope and character of the regulations imposed and of the taxes enacted; and of the further fact that many, if not all, include features, which to some extent, have not been applied generally to other interstate business. . . . [Its] purpose was evidently to throw the whole weight of its power behind the state systems, notwithstanding these variations." *Prudential Ins. Co.* v. *Benjamin, supra,* 328 U.S. 430.

See also *Wilburn Boat Co.* v. *Fireman's Fund Insurance,* 348 U.S. 310 (1955); *Maryland Casualty Co.* v. *Cushing,* 347 U.S. 409 (1954); *North Little Rock Transportation Co.* v. *Casualty Reciprocal Ex-*

change, 181 F. 2d 174 (8th Cir. 1950), cert. denied 340 U.S. 823 (1950).

Congress did have knowledge of the local variations in state systems of regulation and taxation. It rejected a Department of Justice recommendation "that the Federal Government should interfere with State regulation where the latter is not adequate according to a standard determined by the Department of Justice" (H. Rep. 873, 78th Cong., 1st Sess., Nov. 18, 1943, p. 7). That suggestion was prophetic of SEC's present theme, that its jurisdiction should be expanded because SEC thinks that its supervision of VALIC is "needed." The Report stated:

> ". . . The committee is not impressed by such argument. If the States are to be permitted to regulate, they should be permitted to regulate as they see fit. The Committee believe that in considering the nature of the business of insurance, its closeness to policyholders in the several States, the established systems of regulation and control by the States, and the experience and attitude of State insurance Commissioners, regulation by the States should not be circumscribed by the establishment of any control over their power of regulation or the exercise by them of that power."[8]

The McCarran Act and similar legislation was under consideration by Congress for two years. Its language evidences the most precise draftsmanship. It specifies the areas in which federal power under general regulatory statutes is preserved: the Sherman Act remains applicable to all agreements to boycott, coerce, or intimidate (§ 3(b)); the Sherman Act (in other re-

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[8] As Senator Ferguson remarked: ". . . we believe that all the wisdom is not here in Congress. We believe that there is some wisdom left in the legislatures of the various states, and that they should exercise their judgment and regulate insurance . . ." (91 Cong. Rec. 1481).

spects) and the Clayton and the Federal Trade Commission Acts remain applicable (since June 30, 1948) to the extent the business of insurance is not regulated by state law (§ 2(b)) the National Labor Relations Act, the Fair Labor Standards Act of 1938, and the Merchant Marine Act of 1920 remain fully applicable (§ 4). Neither the 1933 Act nor the 1940 Act were placed in the category reserved to federal control.

In the 80th Congress, shortly after the McCarran Act, five bills were introduced to assure that District Insurance Laws satisfied the McCarran Act. One of these, after careful legislative consideration, became the Act of May 20, 1948, 62 Stat. 242.

The *Hearings Before Subcommittee On . . . Insurance of the Committee on the District of Columbia, House of Representatives,* 80th Cong., 1st Sess., May 7, 1947, show Congress' intent to invest in the Insurance Superintendent full responsibility for insurance regulation, leaving no gaps for federal agencies to occupy.

Before the Subcommittee of the Senate Committee on the District of Columbia, Senator Cain observed to the Insurance Superintendent (Mr. Jordan):

> "I daresay that you have the authority, in your general powers, to examine any new insurance situation that comes up, and either take action on the situation or recommend legislation to accommodate its needs" (*Steno. Tr. Hearing March 8, 1948,* p. 13).

When a situation arises which in his judgment calls for Congressional action, the Insurance Superintendent recommends legislation, e.g., Public Law 85-334 (72 Stat. 19), approved February 22, 1958. This Act made significant changes in the insurance laws of the District. It gave the Insurance Superintendent added regulatory powers in the public interest: for example,

he may refuse to issue or renew a certificate of authority or license if the issuance or renewal "would adversely affect the public interest" (Sec. 5). This statute, though passed months after the widely publicized trial of this action, made no change in the law under which VALIC is incorporated and carries on its business of insurance. The 1958 amendment, however, afforded SEC the opportunity, as the trial court suggested, to make its arguments "to the Congress" (Opinion, R. 91). SEC apparently found that prospect unattractive. Clearly Congress found no need to add legislation relative to the variable annuity.

In the McCarran Act, we have an unambiguous statute in a coherent scheme of regulation. The Acts of 1933 and 1940 exclude from SEC jurisdiction insurance companies and the contracts issued by such companies under the supervision of State insurance authorities (See Points III and IV below). The McCarran Act broadly declares (subject to specific exceptions not here applicable) the policy of State insurance regulation.

The most recent efforts of a federal agency to regulate insurance companies were by the Federal Trade Commission. This Court rejected the Commission's claim to superimpose federal upon state regulation. *F.T.C.* v. *National Casualty Co., et al.,* 357 U.S. 560 (June 30, 1958).

C. INSURANCE REGULATORY STATUTES AND INSURANCE ADMINISTRATIVE DEPARTMENTS FULLY PROTECT THE PUBLIC INTEREST

The SEC brief, if read by one unfamiliar with the administrative agencies of this nation, would create the impression that VALIC is subject to no regulation. On the contrary, as stated by one witness, insur-

ance companies "are already subject to so rigid a supervision that the interest of the public and of our policyholders is adequately protected" (R. 434).

The regulation of life insurance through state officials is in its 100th year. Regulation of the life insurance industry is effectuated through legislation,[9] administrative agencies, and judicial interpretations. Uniformity is promoted through the National Association of Insurance Commissioners (R. 501).[10] Official regulation is supplemented, by codes of ethics and similar self-regulatory forces, through twenty-odd trade organizations.[1]

In the District of Columbia, Title 35 of the Code (1951) sets forth the basic insurance law in 253 sections covering some 100 pages. Chapters 3-8 are "The Life Insurance Act." These statutes (not mentioning the extensive regulation in six other states)[2] dispel

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[9] The citations to the insurance codes of the States and territories and regulation of annuities by the state insurance commissioners are set forth in Appendix I, pp. 1a-5a, *infra*.

[10] The state commissioners are listed in 1958 LIFE INSURANCE FACT BOOK, p. 112.

SEC incorrectly states (Br. p. 43) that in some states securities commissioners have jurisdiction over insurance. In no state does the operation of insurance companies come within the jurisdiction of a securities commissioner. What SEC probably means is that in some jurisdictions the same individual holds both the office of insurance superintendent and that of securities administrator (Florida, Hawaii, Montana, South Dakota, and Vermont), and that in three states, regulation of "securities" is handled by the local insurance commissioner (Iowa, New Hampshire, and South Carolina).

[1] Listed, id. at p. 113.

[2] Life insurance companies are subject to multiple State regulation, i.e., the laws of each State in which insurance contracts are sold are applicable. Thus, "convention" examinations of life insurance companies are made by examiners representing a group of State insurance departments, including the department having jurisdiction of a domestic insurance company (R. 512). VALIC

any anxiety which SEC pretends for VALIC policyholders. The SEC "does not argue that [these] statutory provisions were mere pretense." *F.T.C.* v. *National Casualty Co.*, 357 U.S. 560, 564 (1957). VALIC operates under affirmative authority evidencing the insurance authorities' application of the insurance statutes to this individual case. Rather, SEC merely ignores the District/state insurance regulation.

We summarize the District statutes:

The Insurance Superintendent is vested with supervision of all matter pertaining to insurance and insurance companies, subject only to the general supervision of the Commissioners (L.I.A. § 35-101). His office is public, and records, books and papers on file are public records (L.I.A. § 35-401).

Disclosure requirements. Nothing in SEC practice approaches the disclosure required by the Life Insurance Act. Certain of its provisions are printed in full as App. VI, p. 10a-14a.

The Life Insurance Act requires the filing of annual financial and statistical reports with the Insurance Superintendent, and publication of a summary financial report in a District newspaper (L.I.A. § 35-103, 35-407). VALIC's annual report to the Superintendent is on the standard form (L.I.A. § 35-406, 407; § 47-1802) recommended by the National Association of Insurance Commissioners. (P. Ex. 5, R. 186, 653) This report, 42 pages each 12" × 19", is "designed to ferret out every fact which the [NAIC] committees, over the years, have deemed significant," and is on file and available for inspection by any interested party in any

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also is subject to examination at the discretion of any insurance commissioner of any state in which it is authorized to do business. E. g., West Virginia Code (1955) § 3296; Arkansas (1957 replacement) § 66-115; Kentucky Rev. Stat. (1955 ed.) § 304.030; Alabama § 51, Title 28; New Mexico § 58-S-13.

State where VALIC operates (SEC expert, R. 268).

The Superintendent submits to Congress annually a printed report on each insurance company subject to his jurisdiction, which report is a public document (L.I.A. § 35-106, 35-107).

The Insurance Superintendent may examine the company at any time, and must examine it once each three years; and these examinations may include, at his discretion, interrogation of every person having knowledge of the company (L.I.A. § 35-418).[3] The subpoena power (L.I.A. § 35-412) is supplemented by an immunity statute (L.I.A. § 35-802). The examiner's report to the Superintendent may be published in a newspaper (L.I.A. § 35-418).

Regulation and supervision through the potent instrument of examinations, the accepted procedure in insurance and banking, is not contemplated or provided under the 1933 Act, and has not been the practice of SEC under the 1940 Act.[4] The unavoidable shortcomings of mere "disclosure" are emphasized by the volunteered comment of SEC's expert that, "of course, many matters relating to solvency could only be determined on examination" (R. 268).

Sanctions against misrepresentations or misleading

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[3] The National Association of Insurance Commissioners has recommended standard examination laws and provided state authorities with manuals to standardize examinations (R. 121). The extensive scope of a typical insurance company examination was described by the SEC expert (R. 117-18).

[4] SEC 23rd Annual Report for 1957, page 160:

> ". . . Because of urgent needs for man-power for other functions under the Investment Company Act, it has not been possible to make as many inspections as the Commission thinks desirable, and only six inspections were completed during the fiscal year 1957. This program will be continued to the extent that other workload and appropriations permit."

statements. The Life Insurance Act blankets this field:

The company is subject to revocation of authority to do business, its agents to cancellation of license, if any officer, director, general agent, solicitor, broker, or other person falsely represents the terms or benefits of a policy, "or the dividends or shares of surplus to be received thereon," or other facts concerning the company's operation (L.I.A. § 35-714). Congress here clearly contemplated policies under which a share of surplus would inure to policyholders.

Advertising standards are set, and violation is a misdemeanor (L.I.A. § 35-409, § 35-410). Directors are personally liable for any of eight types of misconduct, including false notices or deceiving the public (L.I.A. § 35-526). A director, officer, agent or employee wilfully making any false statement in any statement required by law is subject to imprisonment for 2-10 years (L.I.A. §35-408). The license of a general agent, agent, or solicitor may be suspended or revoked for any of eight reasons, including misrepresentation or a finding that he is "untrustworthy" (L.I.A. § 35-426).

Organization. Proposed articles of incorporation, together with $10,000 bond, are filed with the Superintendent, and a newspaper notice is required (L.I.A. § 35-502). The Corporation Counsel of the District of Columbia examines the proposed articles and, if he so finds, certifies them to be in accordance with law L.I.A. § 35-503). The Company must deposit secuities of not less than $100,000 to protect policyholders (L.I.A. § 35-415, § 35-416). Pending organization, the Superintendent may examine any person under oath, and all books and records (L.I.A. § 35-506). He must be satisfied as to the company's qualifications before he authorizes it to act, and he may refuse to issue or renew a certificate of authority if issuance or renewal "would adversely affect

the public interest" (L.I.A. § 35-404). The Superintendent's certificate of authority to the insurance company (L.I.A. § 35-503) is on an annual basis (F.F. 6, 8, 9, R. 96), revocable for impropriety (L.I.A. § 35-405). The company must keep its principal office and its records in the District (L.I.A. § 35-204).

Policies. All life insurance and annuity policies must be approved by the Superintendent (L.I.A. § 35-705, § 35-708). They must include standard provisions (life, L.I.A. § 35-730; annuities, L.I.A. § 35-705). Certain other types of provisions are prohibited (L.I.A. § 35-704). All applications, riders, and endorsements relating to annuities must be approved (L.I.A. § 35-705).

SEC does not pass on the merits of, or approve, any security.[5] It is a felony to represent that it does so (1933 Act § 23, 15 U.S.C. § 77w; see also R. 726).

Investments. All investments must be in media approved by the Life Insurance Act as lawful for insur-

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[5] Cf. address by SEC Chairman J. Sinclair Armstrong, to Investment Bankers Association of America, Nov. 26, 1956: ". . . the Federal securities laws do not, and I hope never will, give the Commission power to pass on the merits of securities."

Cf. also testimony of Harold E. Wood, Chairman of Board of NASD, in March, 1955 with respect to the situation in uranium stocks:

> "We . . . are acutely aware of the problem . . . There is nothing that we can do . . . except as there may be bad practice in the sale of those securities. After all, they have to register in one form or another with 'SEC' which is purely a matter of disclosure . . . It is not a matter of the quality or lack of quality of the stock . . . and when the issue is registered with the SEC and there is full disclosure, they are helpless and we are helpless to do anything about that . . . If you do anything else, though, than require a full disclosure, you are getting into a paternalistic situation." STOCK MARKET STUDY, *Hearings before Senate Committee on Banking and Currency*, March 8, 1955, pp. 322-323, 325.

ance companies (L.I.A. § 35-535), described at pp. 38-39 *supra*.

Sales activities. VALIC, like other life insurance companies, operates through the agency system (F.F. 25, R. 99). Each general and soliciting agent must be licensed by the insurance authority of his State/District (ibid). The applicant for an agent's or broker's license must supply full details, some specified in the law, "and such other information as the Superintendent may require" (L.I.A. § 35-425, § 35-428). An applicant for a broker's license may be subjected to examination (L.I.A. § 35-428). When the Superintendent is satisfied of the qualifications and trustworthiness of the applicant, he issues a license on an annual basis (L.I.A. § 35-425, § 35-428).

Superintendent's power to suspend company operations. The Superintendent may suspend the authority of any life insurance company to operate when he considers further transaction of business hazardous to policyholders, creditors or "the public" (L.I.A. § 35-405). After notice and hearing, he may revoke the authority to do business for any of eleven reasons, including impairment of capital or surplus, failure to comply with the law, misrepresenting the "terms of any policy," or use of "any name or title of any policy . . . . misrepresenting the true nature thereof" (L.I.A. § 35-405). He may apply to the District Court for a show cause order to take possession of the company's property and conduct its business for any of six reasons, ranging from insolvency, to a finding that further business will be hazardous to policyholders, to a general finding of "activities against public policy" (L.I.A. § 35-419).

Annually the Superintendent examines and certifies the valuation of VALIC's policy reserves (L.I.A. § 35-701(a); D. Ex. 1, R. 812). The statute vests in

the Superintendent discretion with respect to reserves for life insurance policies providing a varying amount of insurance or varying premiums, for annuities, and for other forms of coverage (L.I.A. § 35-701(c)(2)(B).

The Insurance Superintendent, vested with such powers, obviously cannot be downgraded, as SEC would desire, to a minor officer merely concerned with solvency (See SEC Br. 13, 34). Much less is he the mere ministerial officer that NASD would make him on the basis of an inapposite citation of the 1908 decision of *Drake* v. *United States ex rel. Bates,* 30 App. D. C. 312. The *Drake* case dealt with the first District Insurance Law (Act of March 3, 1901, 31 Stat. 1189 at 1289), which consisted of less than five pages (13 sections), and related solely to the companies, fixing no standards for agents. It was not this rudimentary regulatory scheme which existed in 1933, 1940, and 1945 when Congress made clear its intention to preserve the state regulation of insurance.

D. THE McCARRAN ACT BARS SEC FROM REGULATORY JURISDICTION OVER VALIC OR ITS POLICIES

SEC attempts to deal summarily with the McCarran Act, and NASD dismisses it in one page (SEC Br. 54, NASD Br. 51). That a basic ground of the decision of both lower courts is afforded such a cursory treatment suggests an inability to meet the issue head-on.

SEC argues that the term "business of insurance" in the McCarran Act "goes no further than the insurance exemptions of the Securities Act and the Investment Company Act" (SEC Br. 55). This misreads the legislative history, the Congressional intent, and the clear meaning of all three Acts:

The McCarran Act is a broad and all-inclusive statute by which Congress, until it legislates otherwise, relinquished to the states the regulation of the "busi-

ness of insurance." The District Insurance Laws, summarized above, show the scope of such state regulation. Section 3(a)(8) of the 1933 Act and § 3(c)(3) of the 1940 Act, in contrast, were designed to exclude particular aspects of the business of insurance from the reach of those statutes in order to avoid confusion and duplication within the scopes of the Acts of which they were parts. When this was made clear by the excluding provisions, Congress had no occasion to consider other phases of the industry's activities.

Of course, "there is no basis for the assumption that Congress meant by insurance anything different in one statute from the others" (SEC Br. 55). But the word "insurance" does not stand alone in any of the Acts. In each, it is part of a phrase. The fact that each of these distinct terms or phrases contains the common word "insurance" affords no support to SEC's effort to equate them all. Congress has a full appreciation of the meaning of "insurance" and has mentioned it not only in the Securities Acts but in other statutes.[6] These various references were not for the purpose of regulating the "business of insurance" and were not intended to supersede state regulation.

SEC advances the contention that it would be "unreasonable" to give weight to the decisions of the individual state insurance commissioners "since such an interpretation would result in the provisions of the securities law being inapplicable in some states and applicable in others" (SEC Br. 55). This assertion

[6] For example, Congress has authorized the Interstate Commerce Commission to regulate freight forwarders as to insurance of the property they handle (49 U.S.C. § 1003); the Secretary of Agriculture to require a warehouse license to include insurance in the bond furnished (7 U.S.C. § 247); the Federal Housing Administration to insure mortgages (12 U.S.C. § 1713 et seq.); the Housing and Home Finance Administrator to insure realty which he acquires (42 U.S.C. § 1544); etc.

is a complete non sequitur which attempts to turn the issue from the case before the Court to academic, imagined possibilities which have no factual existence.

This litigation is concerned solely with the facts in this record: The respondents have been authorized under the insurance laws of the District and six states to offer in those jurisdictions, as one of their policy products, the variable life annuity. Obviously, such companies cannot do business in a state in which they have not been licensed by the state insurance authorities, and there is no contention that VALIC has done so. There is nothing either unusual or sinister in variation in state insurance laws, or in the fact that frequently a form of insurance approved in one state is not approved in another.

Hence this action is not concerned with academic questions about states where local insurance laws at this moment do not permit life insurance companies to write variable annuities. Probably this is the situation in Connecticut.[7] That creates no problem for SEC: if life companies cannot write these policies in Connecticut, it is doubly certain that no other type of organization can do so.

SEC concedes, as it must, that "insurance commissioners in some states and the District of Columbia have determined that these contracts are insurance" (SEC Br. 13-14) and that VALIC is an insurance company (SEC Br. 14, 52). The insurance commissioners have made these affirmative determinations under the insurance laws of their respective states/Dis-

[7] *Spellacy* [Insurance Commissioner] v. *The American Life Insurance Ass'n*, 144 Conn. 346, 131 A. 2d 834 (1957), though pressed by both SEC and NASD, has no bearing on the issues of this action. The Court was construing the state's insurance laws and did not hold the variable endowment to be a "security." See pp. 90-91, *infra*

trict. Now SEC asks this Court to permit SEC, by its "contrary interpretation" (SEC Br. 14) of such state District insurance laws, to overrule the affirmative determinations of these District and State insurance authorities. This argument (SEC Br. 44) is in direct conflict with the position taken in this Court nine months earlier by the Federal Trade Commission. Said the Counsel for the FTC:

> "the issue before the Court is not whether the Federal Trade Commission Act can be applied so as to override state policy specifically expressed either in statutes or administrative action. Congress, we think, has resolved that issue in the negative . . ."
>
> FTC Brief p. 23 (repeated p. 39), in *Federal Trade Commission* v. *National Casualty Co.*, October Term 1957, Cause No. 436.

The state insurance commissioner does not determine whether a given contract is a "security" subject to the jurisdiction of SEC under the federal Securities Acts. The District/state insurance commissioner, however, has both the authority and the duty to determine, under the insurance laws of his jurisdiction, whether organizational papers submitted to him will constitute the charter for an insurance company, and whether tendered forms of contracts represent lawful coverages to be sold by insurance companies doing business in his state under his regulation. It is noteworthy that SEC does not contend that any of the decisions relating to VALIC which have been made by the several insurance commissioners were incorrect under the respective state/District insurance statutes.

When the question arises under state law as to whether a given corporate structure shall be authorized and regulated as an insurance company, or a given contract shall be approved for sale by insurance com-

panies as a part of the business of insurance under state law, only chaos could result from holding that the state insurance commissioner and the SEC are empowered to give directly conflicting rulings.

SEC's next argument is based on a statement (SEC Br. 59) which is so inaccurate that VALIC quotes to avoid possible misconstruction:

> "The only basis on which it could be argued that the McCarran Act . . . [bars SEC] . . . would be . . . that, insofar as regulation by [SEC] differs from that of the *state insurance commissioner*, it would thereby 'invalidate . . .' [etc.] . . . the State's *insurance* laws. But this is not realistic in the light of the *specific clauses in both Acts*, Section 18 of the Securities Act (15 U.S.C. 77(r)) and Section 50 of the Investment Company Act (15 U.S.C. 80a-49), *preserving to the state regulatory bodies their jurisdiction*" (emphasis added).

This statement erroneously represents to this Court that the cited sections relate to "state insurance commissioner[s]" and "State's insurance laws." Neither statute (quoted SEC Br. 65 and 67) has any reference to state insurance laws or insurance commissioners. They refer solely to the survival of jurisdiction of state securities administrators.

SEC at Br. p. 61 acknowledges state insurance regulation, but asserts that dual regulation "in certain of these areas" was contemplated by Congress. SEC adds to the two sections mentioned in the quotation above, § 12(g) of the 1940 Act. That subsection, not quoted by the SEC Appendix, appears in § 12: "Functions and Activities of Investment Companies." Since insurance companies are excluded from the definition of "investment companies" (see p. 99, *infra*), it can not be a provision contemplating dual regulation. It permits "investment companies," de-

spite the prohibition in § 12(d)(2), under certain conditions to purchase stock in state regulated insurance companies. The final sentence, referring to insurance commissioners, manifestly was intended to reemphasize the fact that the 1940 Act was not invading the field of insurance regulation. It did not vest in SEC jurisdiction with respect to the company in whose stock the investment company invested. What SEC's line of argument, if accepted, would do to state and federal systems for the regulation of insurance companies, banks, common carriers, communications agencies and public utilities staggers the imagination.

Putting aside this manifestly specious line of argument (which NASD does not even advance), we reach the question of whether SEC's attempt to regulate VALIC would supersede, invalidate or impair present District/state insurance supervision. On this point SEC pleads in avoidance: it argues that, irrespective of such supersession, invalidation or impairment, it has jurisdiction because (it says) the 1933 Act and the 1940 Act "specifically relate to the business of insurance" (SEC Br. 60). To support this theory, SEC says the Acts contain "references to insurance." The only reference to "insurance" in the 1933 Act is § 3(a)(8), designed to make clear that insurance contracts are not within that statute (Point III *infra*). In the 1940 Act there are references, cited by SEC, the major one excluding insurance companies from its reach, and others housekeeping provisions, and catch-alls to make sure that no hiatus of regulation occurs through legislative oversight. SEC cites these provisions and drops them, presumably because it is unable to point to any facts in or outside the record to indicate that they have ever been viewed as a warranty for SEC's superseding state insurance regulation.

The McCarran Act provides (§ 2(b)) that an Act of Congress shall have potency to invalidate, impair or

supersede state laws regulating insurance only if the federal act "specifically relates to the business of insurance." It seems too clear to require argument that Congress did not intend that such destructive effect should be given to every casual reference to "insurance" in any federal statute. This saving clause was designed to avoid conflict should Congress enact statutes subjecting to federal regulation the business of insurance or some aspect of it pursuant to a considered legislative judgment that federal regulation was required.

SEC asserts (Br. 57) that in *Maryland Casualty Co.* v. *Cushing,* 347 U.S. 409 (1954), "this Court had occasion to determine the extent to which federal law had been suspended . . ." This characterization overstates the *Cushing* opinions. That case "involved an alleged clash between Louisiana's direct action statute and the [federal Limited Liability] Act. The majority concluded there was no clash." Mr. Justice Clark, for the Court, in *Lake Tankers Corp.* v. *Henn,* 354 U.S. 147, 153 (1957). In *Cushing,* it will be recalled, the justices split four-four-one. Four (opinion by Mr. Justice Frankfurter) concluded that the state had no power to intrude in the exclusively federal maritime jurisdiction, and set the McCarran Act aside as irrelevant (347 U.S. at 413). Four (opinion by Mr. Justice Black) concluded that the decision of the lower court should be affirmed on several grounds, one of which was the McCarran Act. They found in the fact that the McCarran Act followed *South-Eastern Underwriters*

> ". . . no reason for giving the law an unnaturally narrow construction squarely in the teeth of the plain, normal, everyday meaning of the language used. The Act rather shows the strong purpose of Congress to permit states to continue regulating insurance as they always had" (347 U.S. at 437).

Mr. Justice Clark concluded that determination of the insurer's liability should be deferred until conclusion of the limitation of liability proceeding. To resolve the deadlock, this was the order entered. The *Cushing* and *Lake Tankers* opinions show that SEC misreads the views of Mr. Justice Clark (SEC Br. 58).

The *Cushing* case dealt, at best, with a fringe area of state/federal conflict in the field of insurance. Here the Court is concerned with the heart of the business: the organizational form and capital structure of the insurance company itself, and the scope and form of the policies which the insurance company may offer under state statutes. As stated shortly after the *Cushing* case, in litigation involving marine insurance:

> "... state regulatory power, exercised with federal consent or acquiesence, has always been particularly broad in relation to insurance companies and the contracts they make.
> "... the McCarran Act, was designed to assure that existing state power to regulate insurance would continue. ..."
> *Wilburn Boat Co.* v. *Fireman's Ins. Co.*, 348 U.S. 310, 314, 319 (1955).

The Court is confronted here with a conflict between the affirmative ruling of the District and state insurance commissioners, and the contentions advanced by SEC. In the light of the evident Congressional intent to dovetail state and federal regulation, this is a matter for state administrative decision if we are to recognize "the cooperative conception" of federalism that "the National Government and the States are mutually complementary parts of a *single* governmental mechanism all of whose powers are intended to realize the current purpose of government according to their applicability to the problem in hand." Corbin, *The*

Passing of Dual Federalism, 36 Va. L. Rev. 1, 19 (1950).[8]

III

VALIC's VARIABLE LIFE ANNUITY POLICIES ARE NOT "SECURITIES" WITHIN THE SECURITIES ACTS

A. THE DISTINCTION BETWEEN "SECURITIES" AND "INSURANCE"

The difficulty with SEC's case is that SEC is trying to induce the courts to disregard the fundamental distinction between an "insurance contract" and a "security." Though both involve collective activity, they are utterly different in (a) the risks involved and (b) the basis of realization (payments).

Risk: the contingency of life.

We have seen that the life contingency risk under the annuity contract is longevity. "The health of an annuitant affects the substance of an annuity contract as materially as the the health of an assured affects the substance of a life insurance contract.... In either case, death determines the contract." *Woodworth* v. *Prudential Ins. Co.*, 171 Misc. 585, 13 N.Y. Supp. 2d 145, 148-149 (Sup. Ct. 1939). Hence premiums paid by insured A may be applied in whole or in part to pay benefits to insured B.

A "security," on the other hand, does not involve any life contingency. Whether a particular security holder lives or dies has no financial significance either

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[8] This Court, speaking of the power of the Interstate Commerce Commission in exceptional fact cases to deal with intrastate rates, recently reiterated that "the justification for its exercise must 'clearly appear'" because of "the inevitable irritations inherent in the conflict." *Chicago, Milwaukee, St. Paul & Pacific R. Co.* v. *Illinois*, 355 U.S. 300 (1958).

to the organization issuing the security, or to other security holders. As SEC itself says, "His risk is identical to that of all others who purchase the same security" (Br. 33-34).

Realization:

In life insurance annuities, the annuitant receives an amount which differs from that of other policyholders, reflecting age, sex, life contingency, and the time when premium payments began. Realization depends on facts unique to the individual: when born, sex, and date of death. The annuitant cannot outlive his annuity; it does not survive him.

Every holder of a "security," a participant in a common enterprise, receives the same payment as every other holder of the security, under exactly the same circumstances (conceded, SEC Br. 33-34, quoted *supra*). A security produces income or realization of principal totally unrelated both to the duration of life of the investor and to the lives of the group of investors.

This personal character of life insurance and annuities is one of the reasons, of course, why life annuity policies are not traded in as "securities." Securities men who testified for SEC confirmed that never had they sold anything dependent for its existence on the continued life of the purchaser (R. 306), and that there is no market for a life annuity (R. 392).

See *United States* v. *Leslie Salt Co.*, 350 U.S. 383 (1956) wherein, in deciding whether promissory notes fell within the language of the statute: "all instruments, however termed . . . known generally as corporate securities" and within the Treasury ruling as "instruments having the general character of investment securities", this Court said, at page 393:

> "The essence of an 'investment security' is, of course, marketability, and this basic feature the Leslie Salt notes did not have."

No court has ever held to be a "security" a policy issued by an insurance company under the supervision of state insurance authorities, which contract, approved by such authorities, provided benefits calculated on actuarial principles and dependent as to amount and duration on age, sex, and contingency of the life of a specific individual.

This Court applied this analysis in *Helvering* v. *Le Gierse,* 312 U.S. 531 (1941) (cited NASD Br. 20, 31, 33, 39, 45, not cited SEC Br.) and *Estate of Keller* v. *Commissioner,* 312 U.S. 543 (1941) (cited NASD Br. 39, 44, 45, not cited SEC Br.). Those cases dealt with the exemption from federal estate taxes of funds received "as life insurance." The insurer, for a lump sum, issued to a purchaser (i) a policy of life insurance, and (ii) a life annuity policy. The premium was calculated so that the ostensible mortality risks cancelled. The Court held that the funds derived from such an arrangement would not be treated as having been received "as insurance" under tax law because there was no shifting and distribution of the mortality risk. The "company assumed no pecuniary risk in respect to the duration of Mr. Tyler's life." *Helvering* v. *Tyler,* 111 F. 2d 422, 426 (8th Cir. 1940). Said the lower court in *Commissioner* v. *Keller's Estate,* 113 F. 2d 833, 835 (3rd Cir. 1940):

> "Mrs. Keller's death, no matter when it occurred could never require the company to look to funds contributed by other policyholders in order to make the life insurance payment."

B. THE DEFINITION OF "SECURITY" IN THE SECURITIES ACTS DOES NOT COVER VARIABLE ANNUITIES

SEC starts with the contention that the Securities Acts "were designed to provide protection for investors purchasing securities *similar to* the variable annuity" (SEC Br. 16, emphasis added). Nearly 25% of the SEC Brief (pp. 19-33) attempts to analogize the premium payment period of VALIC's policies to "periodic payment plans" of investment trusts in the 1930's.

The material relating to periodic payment plans, quoted at such length by SEC, comes from SEC reports dated in 1939.[9] It is somewhat difficult to believe that it was influential in the mind of Congress when it framed the definition of "security" in 1933. SEC also quotes from Senate Report No. 1775, 76th Cong., 3d Sess. (1940), but SEC omits the following unequivocal statement from that report:

> ". . . the bill specifically excludes . . . insurance companies . . ." (pp. 12-13).

A similar statement appeared at p. 12 of House Report No. 2639, H. R. 10065 (1940).

In its effort to fit VALIC's policies into the mold of a "security," SEC argues that they are "certificate[s] of interest or participation in any profit sharing agreement" or "investment contracts" (Br. 36). SEC cites *SEC* v. *W. J. Howey Co.*, 328 U.S. 293 (1946) and *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). In the *Howey* case, this Court said:

> "The test is whether the scheme involves an investment of money in a common enterprise with

[9] SEC's entire discussion of periodic payment plans is inapt. The Investment Company Act of 1940, § 2(a)(26), defines periodic payment plan certificates to mean certificates "representing an undivided interest in certain specified securities or in a unit or fund of securities . . ."

profits to come solely from the efforts of others" (328 U.S. 301).

SEC planned its case on this language. Count One of the Complaint, on which all other Counts rest, asserts the misconception that variable life annuities are interests in a "common enterprise." Count One contains that term eleven times (R. 4, 5). Yet neither the Findings of Fact nor either of the lower courts' Opinions even mentions "common enterprise." SEC ignores "common enterprise" in its Statement of Questions Presented and in its Statement of the Case. SEC quite evidently now realizes that annuity policies, whether fixed-dollar or variable, do not involve a "common enterprise." In annuities, the interest of each annuitant is inherently adverse to those of all other annuitants: the group pays and the annuitant prospers when he lives beyond his life expectancy; while the group gains and the annuitant loses when he dies early (R. 467). Variable annuities, like other insurance policies, are the very antithesis of a common enterprise. A life annuity rests on shifting the risks incident to the contingency of life. There was no such insurable contingency involved in *Howey* or *Joiner*.

Not only are variable life annuities fundamentally different from the *Howey-Joiner* type of "investment contract," but equally distinct are the motivations of the purchasers of these two disparate types of instruments. In the *Howey* and *Joiner* cases, the purchasers were moved solely by a desire for profit.[10] As a matter of common sense, every purchaser of an an-

[10] In the *Howey* case this Court referred at page 300 to the investors' "paramount aim of a return of their investments" and said: "Such persons have no desire to occupy the land or develop it themselves; they are attracted solely by the prospects of a return on their investment. . . . The resulting transfer of rights in land is purely incidental."

nuity, whether fixed-dollar, or variable, knows that the aggregate amount (number of payments) to be paid to him is unpredictable, since it will depend on the length of his individual life, and that he cannot have any reasoned basis for expecting a "profit." SEC gives no record reference (none exists) to support its claim that VALIC policyholders bought or looked to the policy as a profit-making venture. The undisputed testimony of SEC's policyholder witnesses (R. 360-376) shows the opposite.

The purchaser of a variable life annuity has a two-fold motive. Primarily, he desires an income guaranteed to continue as long as he may live. As the Court of Appeals said: "But perhaps the most important risk that the purchaser desires to shift when he buys an annuity is that he will live longer than his funds will last" (R. 890). Subordinately, as he enters a contractual relationship which may span half a century or more, he seeks an annuity on which payments will tend to adjust for the changing purchasing power of his dollar. To this end, he assumes two risks, one identical with, one the converse of, risks assumed by anyone purchasing a fixed-dollar life annuity:

(a) He assumes the risk that, due to brevity of his life, the total annuity payments may return only a small proportion of his aggregate premium payments. So of all annuity policies.

(b) He assumes the risk that in periods of declining investment results his annuity payments may be smaller than in periods of rising business activity. This is the reciprocal of the fixed-dollar annuitant's risk of loss of purchasing power when prices are high and gain of purchasing power when they are low (R. 431-432).[1]

[1] Cf. The proposal that trustees in the United Kingdom be prohibited from investing trust funds in obligations or claims expressed in monetary sum—certain—on the ground that historical

These are not the motivations, and this is not the economic context, of one who enters a "common enterprise" for "profit."

In the *Howey* case this Court pointed to the statutory purpose of the Securities Act as relating to the "types of instruments that in our commercial world fall within the ordinary concept of a security" (quoted by the Court from H. Rep. No. 85, 73d Cong., 1st Sess., p. 11). In the *Joiner* case the Court said: "The test rather is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect" (320 U.S. at 352).

Under a definition in terms identical to the 1933 Act, yet omitting the insurance exemption found in the 1933 Act, § 3(a)(8), *Haberman* v. *Equitable Life Assurance Society,* 224 F. 2d 401, 225 F. 2d 837 (5th Cir. 1955), cert. denied 350 U.S. 948 (1956), held that a life annuity is not a "security." The decisive consideration was the life contingency aspect of the contract. Said the Court:

> ". . . Certainly annuities issued by regulated insurance companies are not at all similar to the securities specifically enumerated in the statute. In fact, we would not regard 'investment contract' as a correct description of an annuity . . . [What] makes it essentially an annuity is that it is a form of risk-sharing . . . in an annuity, the risk is that the annuitant may live long, outliving his means for his own support. To the extent that insurance or annuities are risk-sharing, they are certainly not investments. It is true that investments or other objectives can be combined in such plans, but they are not of their essence. Besides, we

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evidence shows that these are actually risk investments. "Agenda For The Age Of Inflation" [The Economist (London) August 25, 1951, pp. 435-437].

> perceive a striking difference between the instruments specifically included . . . and insurance and annuity policies of regulated companies . . . the latter are governed by a special statutory scheme, and reserves are required by law to be maintained for them. Thus we think the general words 'investment contract' cannot be reasonably interpreted as including something so dissimilar to the specifically named instruments, as the annuity in this case. Whether they might include an annuity issued by one not a regulated insurance company, we need not decide" (224 F. 2d at 406).

Accord: *Rinn* v. *New York Life Ins. Co.*, 89 F. 2d 924 (7th Cir. 1937), cert. denied, 302 U.S. 753 (1937); *Bates* v. *Equitable Life Assurance Soc.*, 206 Minn. 482, 288 N.W. 834 (1939); *Hamilton* v. *Penn Mutual Life Ins. Co.*, 196 Miss. 345, 17 So. 2d 278 (1944).

Petitioners have both gone far afield in their effort to unearth something that might be claimed to support their position. NASD (but not SEC) cites the Uniform Securities Act; SEC (but not NASD) cites an alleged "poll" of securities administrators.

The Uniform Securities Act (NASD Br. 23), as amended in August, 1958, can give no comfort to petitioners. It was drafted with "advice" from (among other "security" sources) plaintiff SEC and intervenor NASD.[2] The provisions designed to strike at the variable annuity policy first appeared in a third draft released in April, 1956, almost one year after the first draft.[3] Though the draftsmen, and

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[2] Loss & Cowett, Blue Sky Law, pp. 233-235 (1958) and dust-jacket listing "advisers."

[3] On March 24, 1956, the New York Times reported a press conference with the Chairman of the SEC:

> "No decision, he said, had been made so far on the question of variable annuities. The Commission has deferred hearings

the SEC/NASD "advisers" must have been familiar with the impending institution of this action, which they were attempting to pre-judge, there is no indication that any insurance authorities were consulted. In August, 1958 the Commissioners on Uniform State Laws, meeting in Los Angeles, amended the Uniform Act to make clear that it was not intended, and should not be cited, to support a claim that the variable life annuity is a "security."[4] The amendments should avoid uncertainty in future state legislation and thus forestall such unseemingly administrative quarrels for jurisdiction as that now pending in West Virginia.[5]

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until it can make up its mind whether these are 'securities' as defined in the Securities Act of 1933 and the Securities Exchange Act of 1934."

The New York Herald-Tribune of the same date, reporting the same conference, stated that Mr. Armstrong had "said that Congress ultimately may have to decide whether his agency is to have jurisdiction over variable annuities."

[4] The Commissioners amended the final sentence of the definition of "security" (§ 401 (1)) and bracketed the final clause of § 402(a)(5). The amendment to § 401 (1) eliminated the words "number of dollars" so that it now excludes from "security" an "... annuity contract under which an insurance company promises to pay [a fixed sum of] money . . . periodically." The Commissioners' Comments (as revised), make clear that the purpose of the 1958 amendments was to leave to each state legislature, in the light of its state regulatory system, the determination as to the framework of supervision of life insurance companies issuing variable annuities. As stated in the comment on § 402(a)(5): "Those states which take the position that insurance companies which issue variable annuities are sufficiently regulated by the applicable insurance laws will delete the bracketed language."

[5] The West Virginia action, *State ex rel. Sims, Commissioner of Securities* v. *VALIC*, is referred to SEC Br. 46 and NASD Br. 55. The facts are a matter of record:

On August 24, 1956, the West Virginia Insurance Commissioner promulgated a letter of transmittal (56 WEEKLY UNDERWRITER INS. DEPT. SERV., West Virginia 26-30 (1956), and his regulations

SEC asserts that state authorities differ as to the nature of the variable life annuity (SEC Br. 45). SEC cites a "poll" of state Securities Administrators. C.C.H. Blue Sky Rep., par. 4,711, printed a March, 1957 report of the variable Annuity Committee of the National Association of Securities Administrators. Presumably 47 securities administrators[6] were "polled." The question was: "Under the existing laws of your state, do you [the securities administrator] consider

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governing the sale of variable annuities (D. Ex. 17, R. 406, 824). The letter of transmittal expressed the considered view of the Commissioner:

> "We have concluded that the laws of this State authorize the solicitation and sale of variable annuities by a licensed life insurance company. . . . The regulations follow in general the principles laid down in the report of the Variable Annuities Subcommittee . . . which was adopted by the N.A.I.C. [National Association of Insurance Commissioners] . . . The members of this Department are convinced that properly sold variable annuities have a place in the insurance business world . . ."

On Jan. 9, 1957, Sims, the State Auditor and ex officio Securities Commissioner, purported to issue an order directing VALIC to cease its activities. VALIC brought an action against Sims to test this Order. Sims answer was signed by the state's Attorney General and by the general counsel of NASD (who later obtained leave to remove his name). On final hearing, the Court held that there was no statutory authority for the order, and that it was void. *Variable Annuity Life Ins. Co.* v. *Sims*, Circuit Court, Kanawha County, West Virginia. There was no appeal.

On August 23, 1957, on the relation of Sims, the pending action was brought asking that VALIC be enjoined from carrying on its business under the license and supervision of the Insurance Commissioner. No temporary injunction issued. The case was tried on July 21, 1958. Counsel for NASD and counsel for National Association of Investment Companies were present and advised the Attorney General. NASD filed a brief in the case. The Court has not yet decided the case.

[6] Nevada has no securities administrator; Alaska was not a state.

variable annuities as securities?" The answers are revealing:

Yes	No	Undecided	No answer
21	9	7[7]	10

These figures, objectively examined, bear a significance which can be of little comfort to SEC. Over a period of 25 years, many state blue sky laws have been amended, and in those amendments the "security" definition of the 1933 Act has been influential. Every security administrator "polled" undoubtedly knew of the pendency of this action and of SEC's contentions. The question submitted virtually invited an affirmative answer. Yet only 45 per cent of the state securities administrators were moved to answer "yes," from which the NASA Committee drew the conclusion: "Nearly all of the states consider variable annuities as securities" (C.C.H. Blue Sky Rep. Par. 4711).

The position of the National Association of Insurance Commissioners is clear. It has expressed officially its view that in any state where the sale of variable annuities is authorized,

> "supervision over the company including the issuance and sale of variable annuity contracts should

[7] Iowa answered that there was no official opinion. When the basic report was presented to the NASA convention in October, 1957, Iowa's Deputy Securities Commissioner presented an unofficial view, that regulation should be by the insurance department. He said:

> "At the moment, as we see it, we do have insurance companies engaged in the operation of a trust fund from which the investment return is a very necessary and important factor. Now the addition of a variable annuity consideration does not change in a very material way this basic underlying fact. . . ." PROCEEDINGS 40th CONVENTION N.A.S.A. p. 43 (1957).

come under the jurisdiction of the insurance department." (1956 Proceedings of the National Association of Insurance Commissioners, Vol. 1, 165. Quoted, NASD Petition for Certiorari, p. 45).

Unable by fact, logic, or precedent to drag VALIC's variable life annuities within the Securities Acts definitions of "security," SEC for the first time has advanced in this Court its last-ditch position: it would lift out of VALIC's operations the deferred or optional life annuity, and would split it apart so that SEC could have jurisdiction during "the pay-in period . . . whatever the determination with respect to the pay-out period" (SEC Br. 43). NASD, even at its most extreme, has never urged a regulatory muddle so grotesque.

Piercing the trappings of advocacy, we see that SEC proposes that each VALIC deferred life annuity policy be artificially torn into two or more fragments of contracts.

For analysis, assume a deferred annuity issued to a 35 year-old male with a 30 year period of premium payments, with provision for waiver of premium in event of disability, and with life insurance coverage during the 30 year deferred period (Pl. Ex. 1, R. 125, 567, and D. Ex. 29, R. 406, 840). Under its latest proposal, SEC would take some undefined sort of temporary jurisdiction over whatever portion of this whole policy it might split off and attribute to the annuity benefits. SEC would exercise such jurisdiction for the first thirty years, with the state insurance authorities during those three decades relegated to some undefined never-never land in which they would struggle to find some way to regulate those portions of the policy which SEC might be induced to admit related to life insurance and disability waiver.

Since all the company's assets underlie its reserves for the several types of coverage, SEC and the state insurance authorities would be involved in regulating the same company and the same assets. Then would come that instant—a separate one for each policy—when the passage of time brought into effect the annuity payment provisions: the SEC apparently would fade away without trace, and the long obscured insurance commissioners would emerge to supervise the policy during the remaining years of its effective period. Merely to state such an idea destroys it. It overdignifies the SEC argument even to observe that nothing in the legislative history of any of the federal acts indicates that Congress contemplated the possibility of such a preposterous administrative imbroglio. The short answer appears in *Jordan* v. *Group Health Association,* 71 App. D. C. 38, 107 F. 2d 239, 245 (1939):

> "It is the plan as a whole, not artificially disjointed and segregated single phases of it, with which we are concerned."

C. FALLACIOUS DISTINCTIONS

1. The "fixed dollar" fetish

SEC puts major reliance on the contention that the essential and indispensable characteristic of any life insurance annuity must be a provision for fixed-dollar payments. From this (fallacious) major premise SEC leaps to the non sequitur that a contract providing for the liquidation of the company's liability over the uncertain period of the contract holder's life through periodic payments which are variable, yet precisely determined by contract terms, is a "security."

If SEC's contention were correct—and we shall see that it is not—VALIC's policies would meet the test:

the variable annuity benefits are "fixed amounts" since, as SEC's expert witness agreed, they are definitely determinable on the basis of the formula set out in the policy (R. 254). Fully applicable in this context is the legal maxim, "that is certain which is, by necessary reference, made certain." See *United States* v. *Smith,* 18 U.S. (5 Wheat.) 153, 159 (1820); *Mobile & Ohio R.R. v. Tennessee,* 153 U.S. 486, 497 (1894); *Travelers Fire Ins. Co.* v. *Ranney-Davis Mercantile Co.,* 173 F. 2d 844, 851 (10th Cir. 1949.) This maxim has been applied in determining that an annuity which had a variable feature nevertheless provided "a certain specified sum." *In re Bourn's Estate,* 25 Cal. App. 2d 590, 78 P. 2d 193, 198 (1938).

Aside from the maxim of certainty by established standards of calculation, the SEC contention that every life insurance annuity must provide for fixed-dollar payments has no support in applicable precedent and has been rejected by courts, legislatures, and scholars. It was, of course, rejected by the trial court in the unequivocal finding that "A variable annuity contract, as provided by contracts issued by VALIC, is an annuity . . .," and describing it (F.F. 30, R. 100). As NASD points out (Br. 18), neither it nor SEC excepted to the trial court's findings.

The SEC and NASD briefs accept as authoritative in the insurance field three scholars: Huebner (cited NASD Br. 35, 36, 40, 42), Maclean (cited NASD Br. 34, 35, 36, 40), and Mehr (cited SEC Br. 39). All agree that the insurance definition of a life annuity does not require fixed-dollar payments. Maclean and Mehr so testified at the trial (R. 459, 486). Huebner states in the latest edition of his work:

> "Broadly, an annuity may be defined as a periodic payment made during a fixed period or for the

> duration of a designated life or lives. If the payments are made with reference to life contingencies, the contract is known as a life annuity."[8]

Of the variable annuity, Huebner says in part (p. 100):

> "Instead of providing for the payment each month of a fixed number of dollars, the variable annuity provides for the payment each month or year of the current value of a fixed number of annuity units . . ."

The Securities Act of 1933 does not require frozen, fixed dollar payments. It exempts "any . . . annuity contract or optional annuity contract issued by a corporation subject to the supervision of the insurance commissioner . . ." (1933 Act, § 3(a)(8), 15 U.S.C.A. § 77c).

The District Insurance Code makes no such requirement. There is no contention here that VALIC's policies are unlawful under the District insurance statutes.

The insurance statutes of the District, West Virginia, Kentucky, Arkansas, Alabama, New Mexico and North Dakota make no such requirement. Administering the insurance statutes subject to his jurisdiction, the insurance commissioner of each of these states has approved VALIC's or EALIC's policies and authorized their sale as insurance contracts.

The Federal Government's Treasury Department makes no such requirement. Variable annuity payments are taxable as annuity income. Rev. Rul. 185, 1953-2 Cum. Bul. 202, now incorporated in the Fed. Inc. Tax Regulations § 1.72(b)(3).

Moreover, the variable annuity has received Congressional recognition. In the 85th Congress, 2nd ses-

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[8] HUEBNER & BLACK, LIFE INSURANCE (5th ed. 1958) 91.

sion, Report No. 2277 of the Committee on Ways and Means, which accompanied H.R. 10, relating to the "Self-Employed Individuals' Retirement Act of 1958", it is stated:

> "The restricted retirement policy for which an individual may take a deduction for the premium must fundamentally be an annuity or an endowment policy issued by a domestic life insurance company." (Page 3)

At page 11 of the Report, it is stated:

> ". . . Under subsection (f)(2) no annuity described therein is treated as satisfying the requirements of such subsection if it provides for payments which (after annuity payments begin) may increase for any reason other than dividends or increases in investment income allocable to the policy. A variable annuity therefore can qualify as a restricted retirement policy regardless of increasing annuity payments if such increases are due to increases in investment income, including capital appreciation."

The argument that fixed payments are essential to the insurance concept was rejected in *In re Supreme or Cosmopolitan Council of Brotherhood of Commonwealth*, 193 Misc. 996, 86 N.Y.S. 2d 127 (Sup. Ct. 1949). Each member of a fraternal society made anual payments, which the society invested in income-producing property. Earnings realized, after expenses, were distributed to the members as "dividends." On a member's death, withdrawal, or lapse, his "account" was prorated among the remaining members of his "birth year class." The payments being contingent on the continuance of life, the Court held the transactions to constitute insurance annuities: the fact that the periodic payments were not fixed in amount, but variable, did not change the annuity fea-

ture, since "annuity" does not necessarily mean only "fixed sums payable on specified dates." 86 N.Y.S. 2d at 130. See also 1947 REPORT, N.Y. ATTY. GEN. 214.[9]

Nothing in the District Life Insurance Act suggests that an annuity must (a) guarantee a predetermined minimum level of benefits, or (b) utilize a predetermined minimum assumption as to (1) mortality or (2) investment results.

The SEC must recognize that a life annuity policy issued by a company under insurance regulations would satisfy § 3(a)(8) if it promised any fixed minimum annuity payment, even though the amount be only 10 per cent of that offered by competing insurance companies for the same premium, and even though it be on a participating basis. Such a benefit level might be calculated by actuarial means based on assumptions:

(a) that all annuitants would live to be 110 years old; and

(b) that the company would earn ½ of 1 per cent on the investment of its assets.

Technically this policy would satisfy the apparent yen of SEC for a fixed-dollar minimum but in actual operation an equitable participating feature would make it a variable annuity. Issued by a life insurance company whose assets were substantially invested in common stocks, the hypothetical policy could not be differentiated pragmatically from the annuity policies of VALIC.

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[9] New York Ins. Law § 46 defines "annuities" as "meaning all agreements to make periodical payments where the making or continuance of all or of some of a series of such payments, or the amount of any such payment, is dependent upon the continuance of human life. . . ."

NASD relies (Br. 47-48) (as both SEC and NASD did below) on cases involving wills, trusts and taxes. These decisions were concerned with the transaction from the standpoint of the recipient, whether he was an annuitant, beneficiary, or legatee. None started from the point involved here, the performance of an insurance function by the institution making the payment. The basic issues were of this sort: When does the legacy or interest thereon commence? Shall the corpus be invaded? Is the residue to be charged? They have no relevance to the present controversy.[10] In most, if not all, the decision would have been the same on either fixed or variable payments.

SEC now relies, however, solely on a definition by Lord Coke in the early 17th century and a lay textbook by Clyde C. Crobaugh printed in 1933.

Lord Coke was writing at a time when life insurance, as an institutional service based upon distribution of risk, was in its infancy. Prior to the 17th and 18th centuries, whatever was done in the way of annuities was on a crude basis (R. 479). Modern life insurance stems from the formation over a century later (1756) of The Society for Equitable Assurances on Lives and Survivorships. That company was the first to introduce the idea of varying the amount of premiums according to the entry age of the assured, and its efforts over a period of years to obtain a formal charter were frustrated by the opposition of established forces which feared the competition of its more effective insurance product.[1]

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[10] In their REPLY Brief in the Court of Appeals SEC cited 59 such cases. In this Court, SEC cites none. NASD still cites two (NASD Br. 47-48). They are so manifestly inapplicable that discussion appears unwarranted.

[1] See KNIGHT, THE HISTORY OF LIFE INSURANCE IN THE UNITED STATES TO 1870 (1920) 38-39.

If ancient practices are to shackle our modern economy, however, we should be clear that distinguished scholars do not read Lord Coke's authority as narrowly as does SEC. Thus Pollock and Maitland point to a variable annuity which preceded Lord Coke by centuries:

> "One class of annuities (*sic*) has an instructive history of its own. It consists of the corodies (*conredia*) granted by religious houses . . . . The quantity and quality of the meat, drink, clothes, candles, firewood, that the grantee is to receive will be carefully defined; even the mustard and garlic will not be forgotten."[2]

Crobaugh, recognized in 1933, that the life insurance annuity was not frozen. He said:

> ". . . the forms and kinds of agreements were changed and extended from time to time. . . . Many variations and new agreements came into use as new needs were discerned, and this development is still in progress."[3]

And so it is. Even in the estate and wills field there is no sanctity to "fixed-dollar" amounts. Recently the High Court Justice of Ontario sustained a bequest of a variable annuity which "vested in the beneficiary . . . the right to receive such annuity to be calculated by the trustees in accordance with . . . the procedure laid down . . ." Re *Rogers*, 4 D.L.R. 422, 428-429, 431-433 (1955).

SEC also relies on two cases. Neither was an attempt to enforce a "securities" law. Each determined whether a particular contract was permissible under the insurance laws of the particular state. Each

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[2] HISTORY OF ENGLISH LAW, Vol. 2, p. 134 (1911).

[3] CROBAUGH, ANNUITIES AND THEIR USES (1933) p. 12.

upheld the local insurance commissioner. VALIC agrees that the District/state insurance statutes are the appropriate standards against which to test any contract proposed by an insurance company.

Coastal States Life Ins. Co. v. *Kelly,* [Insurance] Commissioner, Court of Common Pleas, Richland County, So. Car., 1955, unreported (SEC Br. 45, not cited by NASD): there Coastal, a Georgia life insurance company, offered in South Carolina a life insurance policy which included "interim endowments" of $100 a year for 18 years (the first a double amount, $200, after 2 years). The sole issue was the applicability of So. Car. Code (1952) § 37-145, prohibiting an insurance company from issuing any contract offering an "inducement to the taking of insurance." The Insurance Superintendent of South Carolina prohibited issuance of the policy on the ground that the "endowment" provision constituted such an "induce ment." The Court sustained. The SEC reference to this case (Br. 45) misstates both the facts and the holding.

Spellacy, Insurance Commissioner v. *The American Life Insurance Association,* 144 Conn. 346, 131 A. 2d 834 (1957), upheld the Connecticut Insurance Commissioner in ruling that a variable endowment contract could not be issued under present Connecticut law governing fraternal benefit societies. The *Spellacy* contract contained an "option," after 10 years or death, under which "the Association agrees to grant, . . . a variable annuity certificate" for a type of annuity which it might be issuing at the time of election.[4]

[4] The contract provided: "The Variable Annuity Certificate to be issued under this option will be governed in every respect by the terms, conditions, privileges, and provisions which will be contained in the certificate." (Record on Appeal, Connecticut Supreme Court).

The lower court reserved seven questions for Supreme Court decision. Not one even referred to the variable annuity "option." Only one referred to the Securities Law of Connecticut and the Connecticut Court did not answer that question.

With respect to *Coastal States* and *Spellacy*:

(a) There was not the slightest factual similarity to VALIC's officially approved policies; (b) both cases illustrate the effectiveness of state insurance regulation under state insurance statutes; and (c) neither gives any support to a theory that a life annuity policy is a "security" or that SEC should supersede State insurance authorities.

2. The media of company investments

The investment media chosen by an insurance company from those authorized by state insurance laws have never yet been held the criteria for subjecting the company or its policies to any regulatory body other than insurance authorities.[5] The "securities" covered by the Securities Act are those offered to the public, not the issuers' underlying assets. Even as to an issue offered to the public, the Act makes no distinction in its applicability according to whether a bond or stock is being issued; it applies to both equally. *A fortiori,* it is not concerned with whether the issuing company's assets consist of stocks or bonds.

If a relationship between investment results and benefits to policyholders makes a life annuity a "security," fixed-dollar annuities of mutual life insurance companies and participating policies of stock life in-

[5] NASD seems close to appreciating this fact. NASD Br. 42 agrees that "From what source or through what economic methods the insurer acquires the money to meet its contractual obligations is no part of an 'insurance' contract."

surance companies also are "securities." Especially striking is the fixed-dollar participating policy issued in New York by a stock company which offers in that state both participating and non-participating policies: the New York Insurance Law § 216(6) limits the "profits" which may be withheld from annuitants and hence "shall inure to the benefit of the stockholders"; and further provides that

> ". . . . the profits on its participating policies and annuity contracts shall be ascertained by allocating to such policies and annuity contracts specific items of gain, expense or loss attributable to such policies and contracts and an equitable proportion of the general gains or outlays of the company."

The payment of benefits keyed to investment results has long been customary in the life insurance field.

D. THE INSURANCE "EXEMPTION" CONFIRMS THE EXCLUSION OF VALIC's LIFE ANNUITY POLICIES FROM THE SECURITIES ACT OF 1933.

The Securities Act of 1933 § 3(a)(8) "exempts" from the registration requirements thereof:

> "(8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner . . . of . . . the District of Columbia."[6]

The considerations set out earlier in this Brief show that VALIC's life annuity policies are not "securities" within the definition of the 1933 Act.

But the Act contains § 3(a)(8), and for drafting convenience it appears as an "exemption." An "ex-

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[6] "Optional annuity contract" is another term for a deferred annuity contract. See p. .... *supra*.

emption" however, is a provision which removes from the reach of a statute some person, thing, or situation which otherwise would fall within the Act. Congress made unmistakably certain the fact that § 3(a)(8) was not to be viewed as such an "exemption," but was inserted in the Bill to make clear:

> ". . . what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the act. The insurance policy and like contracts are not regarded in the commercial world as securities offered to the public for investment purposes. The entire tenor of the act would lead, even without this specific exemption, to the exclusion of insurance policies from the provisions of the act, but the specific exemption is included to make misinterpretation impossible" (H.R. Rep. No. 85, 73rd Cong., 1st Sess. 15 (1933)).[7]

Congress meticulously defined securities terms used in the 1933 Act, but not the terms used in this exclusion. The test adopted was whether the instrument involved was an insurance contract issued by a company supervised by the State (or District) insurance authorities. Since there is no question but that VALIC is a life insurance company "subject to the supervision of the" Insurance Superintendent, SEC must argue, to escape this explicit provision, that VALIC's policies are not "insurance contracts." This contention, as shown above, is without basis.

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[7] At the time of the quoted report, the House Bill did not contain the words "annuity contract or optional annuity contract," other than by implication in the reference "and like contracts." Simultaneously the Senate was considering S. 875 which specifically mentioned annuity contracts but did not refer to insurance. The present language, reaching both, was inserted in conference. H.R. 152, 73rd Cong., 1st Sess. (1933).

Neither legislative history nor the circumstances under which the Act was passed supports SEC's contention that Congress intended to foreclose progress by excluding only the then-existing forms of insurance policies and annuity contracts. Very recently the government urged before this Court in *Haynes* v. *United States,* 353 U.S. 82 (1957), that health insurance "should be limited to the particular forms of insurance conventionally made available." The Government argued that the Southern Bell Health Insurance Plan should not be treated as "health insurance" because:

> "The employees paid no fixed periodic premiums, there was no definite fund created to assure payment of the disability benefits, and the amount and duration of the benefit varied with the length of service."

In rejecting this contention this Court stated:

> ". . . The payment of premiums in a fixed amount at regular intervals is not a necessary element of insurance. Similarly there is no necessity for a definite fund set aside to meet the insurer's obligations. And the fact that the amount and duration of benefits increased with the length of time that an employee worked for Southern Bell reflected the added value to the company of extra years of experience and service. . . ."
>
> ". . . There is no support in the legislative history for the Government's argument that Congress intended to restrict the exemption provided . . . . The term 'health insurance' was not defined in any of these acts or in any of the committee reports . . . Under these circumstances we see no reason why the term 'health insurance' . . . should not be given its broad general meaning."

Congress knew that no life insurance policy could be written without both approval and continuing supervision by state insurance authorities. It recognized that "expertise" existed in the insurance departments. Nothing indicates that Congress intended to launch the SEC on insurance regulation.

SEC advances the argument that the Securities Acts "should be read to cover" (Br. 33) the life annuity policies issued by VALIC. Ignoring all state regulation, it contends that there is a "practical need" (SEC Br. 42) for it to intervene to protect VALIC's present or potential policyholders. To support this argument, SEC cites *SEC* v. *Ralston Purina Co.*, 346 U.S. 119 (1953). That case dealt only with the determination of whether an offer of company stock to 500 employees should be exempt (under § 4(1) of the 1933 Act) as not involving a "public offering." In contrast to its detailed definition of "security," the 1933 Act contains no definition of "public offering." In determining Congress' intention in using this vague term, this Court looked to legislative history. It pointed out that the words "not involving any public offering" were added to § 4(1) because such an offering was thought to be one, in the words of the House Report, "where there is no practical need for the [bill's] application." The Court said:

> "Since exempt transactions are those as to which 'there is no practical need for [the bill's] application' the applicability of *Section 4(1)* should turn on whether the particular class of persons affected needs the protection of the Act" (346 U.S. at 125. Words italicized were omitted in SEC's quotation, SEC Br. 39).

The difference, therefore, is between a limited reference to "practical need"—the House Report's words in adding the particular phrase involved in *Ralston-Purina*—to ascertain the meaning of two words descriptive of an exempted transaction and SEC's attempt, on a claim of "need," to extend the whole scope of the Securities and the Investment Company Acts to insurance and annuity policies.

SEC's "need" argument is invalid both on the fact and the law. On the facts, unless SEC can show that the insurance regulation to which VALIC is subject is somehow lacking and that SEC jurisdiction will be more effective in protecting the public interest, SEC fails to substantiate the imagined "need." SEC does not try to make that showing. On the law, the argument of "need" in essence means that Congress did not bring VALIC's policies within the Acts, but this Court should read them in. Here VALIC recalls the language of the Trial Court: "The arguments which plaintiff [SEC] advance here should be addressed to Congress" (R. 91).

The definitions of "security" in the Securities Act (§ 2(1)) and the Investment Company Act (§ 2(a)(35)) are identical. The definition in the Securities and Exchange Act of 1934 (Section 3(a)(10)) is substantially the same. VALIC's life annuity contracts cannot be "securities" under one Act without being "securities" under all.

But SEC never mentions the 1934 Act or claims that it "should be read to cover" VALIC's contracts. Perhaps the reason is that the obvious inapplicability to VALIC's insurance activities of the regulatory scheme of the 1934 Act reinforces the inapplicability of the other Acts.

If variable annuities are "securities," all insurance agents[8] who sell them must register with the SEC as "brokers" under § 15 of the 1934 Act and comply with the many SEC rules, and file the many forms and reports, which were designed for "securities" brokers—e.g., Form BD pursuant to Rule X-15B-1; Rule X-15B-8 requiring a statement of financial condition showing "securities of such broker . . . listed in a separate schedule and valued at the market"; Rule X-17A-3 requiring every such broker (insurance agent) to keep current eleven separate categories of books and records, including a "securities record or ledger reflecting separately for each security . . . all 'long' or 'short' positions"; and Rule X-17A-5, which would require every such agent to file a lengthy annual report on a form the items of which are appropriate to the business of securities brokers and dealers.

If variable annuities are "securities" all insurance agents selling them must accordingly attempt to thread their way through a maze of provisions to determine which, if any, may be deemed by SEC to be "needed," and hence to be within the category which "should be read" to reach their activities.

It is particularly to be noted that the 1934 Act contains no exemption of insurance policies and annuity contracts, as does Section 3(a)(8) of the 1933 Act—so that the 1934 Act poses squarely the question whether insurance policies and annuity contracts come within the term "securities."

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[8] In 1955 there were 189,600 full-time life insurance agents in the United States. 1956 LIFE INSURANCE FACT BOOK, Ct. Ex. 1, p. 49.

IV

VALIC IS NOT AN "INVESTMENT COMPANY" UNDER THE INVESTMENT COMPANY ACT OF 1940

No company can be an "investment company" under the 1940 Act unless it is an "issuer" of "securities" (§ 3(a) and 2(a)(21)). Hence for SEC to extend its jurisdiction to VALIC under this Act, SEC first must establish that VALIC's policies are "securities." For the reasons already set forth, SEC has failed to make this showing.

No company can be an "investment company" under the 1940 Act if it is an "insurance company" (id. § 3(c)(3)). Under this explicit exclusion, an insurance company never comes within the Act of 1940 at all, and hence does not require "exemption." "Exemptions" are provided by § 6 for various companies that are included in the definition of "investment company."

SEC is in error, therefore, in stating that VALIC and EALIC "are non-exempt investment companies" (Heading, SEC Br. 48), and that they "fall technically outside the exemption for insurance companies" (SEC Br. 51). SEC's use of the word "technically" indicates the kind of narrow interpretation SEC would like to give to an "exemption," if only it could show that insurance companies were under the necessity of bringing themselves within one.

VALIC meets precisely the definition of "insurance company" in § 2(a)(17) of the 1940 Act, and hence is excluded from that Act:

(1) VALIC is organized as an insurance company (F. F. 3, 5, 6, 8, 9, 11, 13, 15, R. 94-98);

(2) VALIC's sole, and hence its "primary and preponderant," business activity is the sale and servicing

of insurance contracts, including life insurance, disability insurance, and variable life annuities (F. F. 4, 15, 25, 27, 30, 31, 32, 33, 34, 38, R. 95, 98-104, 106);[9]

(3) VALIC is subject to the supervision of the District Insurance Superintendent and the Insurance Departments of West Virginia, Kentucky, Arkansas (F. F. 6, 8, 9, 15, 19, 20, 21, R. 96-98) and since the trial Alabama and New Mexico (App. II and III, pp. 6a and 7a).

Legislative history demonstrates conclusively that Congress did not intend by the Investment Company Act of 1940 to extend SEC jurisdiction to the activities of regulated life insurance companies.

VALIC agrees that "The Investment Company Act of 1940 was enacted to deal with the problems pointed out" in SEC's Reports on Investment Trusts and Investment Companies (SEC Br. 27). These studies were made over a period of years pursuant to the mandate of § 30 of the Public Utility Holding Company Act of 1935 (15 U.S.C. 792-4).

The initial volume of the resulting SEC studies was transmitted to the Senate and House on June 10, 1938. This part "treated of the origin, scope and conduct of the study."[10] This Classification Report recognized "the breadth of the legislative mandate" (p. 1) and

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[9] NASD (Br. 22) concedes that "The primary business conducted by respondents is selling 'variable annuities' to the public." With typical lack of consistency, NASD also says (Br. 30): "Investing and trading in securities is their principal business . . ." The facts sustain the former, not the latter, view of VALIC's activities.

[10] Investment Trusts and Investment Companies, SEC Report, "The Nature, Classification and Origins of Investment Trusts and Investment Companies," H.R. Doc. No. 707, 75th Cong., (1938), p. iii. This volume is cited hereafter "Classification Report."

indicated the thoroughness of the study. It said on its first page:

> "The major portion of the Commission's time and effort in connection with the study was devoted to investment companies of the management type, companies which have no restriction or only limited restrictions on the investments which they make."

This alone would have excluded life insurance companies, whose investments were and are restricted and controlled by state insurance statutes and state insurance commissioners. But the exclusion was explicit:

> "Although banks and trust companies and insurance companies and similar organizations own securities of other corporations, they were not included in the study because their main and primary business is banking and insurance, respectively and not ownership of securities."[1]

Thus, at the very inception, SEC recognized that the "main and primary"—compare Investment Company Act of 1940, § 2(a)(17), "primary and preponderant"—business of insurance companies was not the ownership of securities, but the sale of policies and the payment of benefits thereunder.

The investment companies under study had flowered in the period 1921-1926, their formation being "materially facilitated by the virtual absence of statutory restraint or governmental regulation or supervision. . . . Unlike banks, insurance companies, and trust funds, the new investment vehicle enjoyed almost complete freedom from any protective restrictions."[2]

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[1] Classification Report, pp. 15-16. The exclusion explicitly extended to life insurance companies. Id. p. 33, fn. 30.

[2] Id. p. 63.

With insurance companies, banks, and similar regulated financial institutions excluded from its scope, the study of "Companies Sponsoring Installment Investment Plans," so freely quoted by SEC, is placed in perspective. That Report was transmitted by SEC in September, 1939. At that date, SEC also had in progress its study of legal reserve life insurance companies looking to the submission ten months later of the report which became TNEC MONOGRAPH 28, and which recommended the development of life insurance techniques to broaden industry investment in common stocks.

In this factual setting, SEC's circuity of argument emerges. SEC says that one abuse which led to the Investment Company Act of 1940 was the fact that unregulated investment trusts attempted to give the impression that they were "similar to savings bank thrift plans or insurance endowment plans" (SEC Br. 24). Now SEC tries to reverse the argument. Since investment trusts in the 1930's tried to look like insurance companies, SEC tries to find in VALIC's insurance policies some similar features that (SEC says) look like what the investment trust tried to look like. Hence, SEC says that VALIC is an investment trust.

What is said by SEC of VALIC, of course, can be said about any life insurance company issuing life annuities which offer equitable participation in the investment results of the companies. We have seen that during the 1930's certain legal reserve life insurance companies, by reducing their guaranteed annuity payments to ultra-conservative levels and supplementing those payments by participations, issued what were in essence variable annuities. That this was known by SEC in 1938, 1939, and 1940, when it was working on

studies of investment trust and on the Investment Company Act, has been conclusively demonstrated. TNEC MON. 28, p. 332, transmitted by SEC to TNEC on July 24, 1940.

Life insurance companies traditionally have written retirement annuities as savings devices offering a lifetime income and, during the premium payment period, a reserve of value which could if necessary be used for education of children, business opportunities, or other family purposes. They have made clear that their assets are invested under state insurance laws in widely diversified securities, and mutual life insurance companies or stock life insurance companies issuing participating policies, have publicized the fact that experience demonstrated that "dividends" deriving from investment results would reduce net premium cost and increase retirement annuity payments. Yet there has never, until now, been any claim that such legal reserve life annuity contracts were "interests sold" (SEC Br. 37, fn); and not even now does SEC claim they are "securities."

SEC also quotes from Senate Report No. 1775, 76th Cong., 3d Sess. (1940). It omits, however, quotation of the pertinent statement therein (pp. 12-13), under "Analysis of Provisions of Title I":

> ". . . Provision is made generally to exclude from the bill . . . insurance companies. . . ."

It certainly was not the intent of Congress by the 1940 Act to superimpose federal on top of state insurance regulation. The following exchange (86 Cong. Rec. 10071), in August 1940, between Senator Wagner, sponsor of the bill and Senator Byrnes, is significant:

"Mr. Byrnes: Mr. President, the bill has nothing to do with the regulation of insurance companies?

"Mr. Wagner: Of course not."

The draftsmen of the Act specifically excluded insurance companies. Thus, David Schenker, Chief Counsel for SEC, testified in April, 1940:

> "There we go on to say any bank or insurance company is exempt, and we have to make that specific exemption because fire-insurance companies invest and reinvest in securities, as do also insurance companies and banks." Hearings before Subcommittee of the Committee on Banking and Currency on S. 3580, 76th Cong., 3d Sess., pp. 176-177 (1940); repeated, Hearings before Sub-Committee on Interstate and Foreign Commerce (June, 1940) H.R. 10065, *supra*, p. 102.

A contemporaneous study noted that "while investment companies bear a close resemblance to savings banks and insurance companies, . . . yet legislative curbs comparable to the plethora of regulations which surrounds banks and insurance companies have never been imposed upon investment companies."[3]

Since 1940 there has been no decision even suggesting that a regulated life insurance company could be brought within the Investment Company Act. SEC cites (Br. 50 fn) *Bankers Securities Corp.* v. *S.E.C.*, 146 F. 2d 88 (3d Cir., 1944), apparently hoping to draw sustenance from an incomplete fact statement and one sentence lifted out of context. The title of

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[3] Note "The Investment Company Act of 1940" 41 Columbia L. Rev. 269, 274 (1941). The note adds (277):

> "Likewise organizations which like . . . insurance companies . . . are already subject to adequate governmental supervision . . . are not deemed investment companies within the meaning of the Act."

the defendant company in that case is the cue: Bankers Securities was organized as an investment company for the stated purpose of purchasing, selling and trading in securities. It operated under provisions of the Federal Tax Laws applicable to dealers in securities "held for purposes of resale and not for investment" (146 F. 2d at 90). Obviously, it was an "investment company" under the 1940 Act.

SEC ignores, however, its own decision in *Matter of Aeronautic and Automotive Insurance Agency, Inc.*, 17 SEC 718 (1944). The A & A Agency, an Illinois corporation, operated under a certificate of the Illinois State Director of Insurance pursuant to the Illinois Insurance Code. SEC held that the A & A Agency was not an "investment company" under the 1940 Act, because it was primarily engaged in the insurance brokerage business. SEC's findings conclude:

> "The evidence indicates that the applicant was not organized as an investment company but that it was incorporated to act as an attorney-in-fact for a reciprocal insurance company and to carry on a general insurance and brokerage agency business. Furthermore, the record supports the conclusion that the applicant's investments in the exchange were made for the sole purpose of qualifying the exchange to write contracts and were wholly necessary and incidental to the furtherance and successful prosecution of the applicant's insurance brokerage business. This conclusion is strengthened by the fact that the applicant's principal revenue will consist of a percentage of the premium payments collected by the applicant on insurance contracts written by it rather than income by way of interest payments on the guaranty fund certificates held by it."

Here, of course, VALIC meets every test which SEC in 1944 deemed crucial: VALIC is not organized

as an investment company but as an insurance company to carry on an insurance business. Its stockholders have purchased its stock and contributed to its surplus solely to qualify to write approved insurance contracts. Its basic capital and surplus, represented in part by over $200,000 on deposit with the Superintendent of Insurance, was wholly necessary and incidental to the successful prosecution of its insurance business. Its principal revenue obviously will consist of a percentage of the premium payments on its insurance policies. In short, on objective application of SEC's own criteria, VALIC is not an "investment company."

CONCLUSION

Both petitioners have blinded themselves to two fundamental facts:

A. The mortality guarantee which pools and distributes the life contingency risks of the annuitants—a pure insurance function alien to every concept of a security.

and

B. The effective, detailed supervision of the Insurance Superintendent, under the District Life Insurance Act, and the Insurance Departments of West Virginia, Arkansas, Kentucky, Alabama and New Mexico, afford to VALIC, its policyholders, and the public the fullest of protection.

When these two vital factors are placed in their necessary and proper context in this controversy, it is clear that the judgment of the trial court, affirmed by the Court of Appeals, was correct.

Accordingly, it is respectfully submitted that the judgment of the Court of Appeals should be affirmed on the grounds:

(1) that the variable annuity offered by VALIC is an annuity;

(2) that VALIC is engaged in the "business of insurance";

(3) that VALIC's variable annuity is not a "security" as that term is defined in § 2(1) of the Securities Act of 1933, and, in any event, is exempt from registration under § 3(a)(8) of that Act; and

(4) that VALIC is not an "investment company" as that term is defined in § 3(a) of the Investment Company Act of 1940, and, in any event, is exempt from registration under § 3(c)(3) of that Act.

Respectfully submitted,

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APPENDIX I

Citations to the Insurance Codes of the States and Territories and regulation of annuities by the state insurance commissioners

ALABAMA: Title 28 "Insurance" of the Code of Alabama, 1940 (and supplements), Sec. 4.

ALASKA: Title 42 "Insurance" of the Alaska Compiled Laws, Annotated, Secs. 42-1-3, 42-1-4, and 42-1-5.

ARIZONA: Title 61 "Insurance" of the Arizona Revised Statutes, Annotated, (1956), 1958 Cumulative Pocket Part), Secs. 61-101 and 61-102.

ARKANSAS: Title 66 "Insurance" of the Arkansas Statutes (1947) Annotated, official edition (1957 Replacement), Sec. 66-201.

CALIFORNIA: "Insurance Code" (2 Volumes), West's Annotated California Code, 1955 edition, Secs. 22 and 101.

COLORADO: Chapter 72 "Insurance", of the Colorado Revised Statutes (1953), 1957 Cumulative Supplement, Sec. 72-1-41. See also Sec. 72-6-6.

CONNECTICUT: Title XLII "Insurance" of the General Statutes of Connecticut, Revised edition of 1949), Sec. 6144.

DELAWARE: Title 18 "Insurance" of the Delaware Code, Annotated, 1953, with Supplements, Secs. 18-101, 18-903. See also Sec. 18-915.

DISTRICT OF COLUMBIA: Title 35 "Insurance", District of Columbia Code, 1951 edition (and Supplement), Chapters 3 to 8, inclusive.

FLORIDA: Title XXXV "Insurance", Florida Statutes Annotated, Sec. 625.01.

GEORGIA: Title 56 "Insurance" of the Code of Georgia, Annotated with Annual Pocket Parts (1955), Sec. 56-901 and 56-906.

HAWAII: Chapter 181 "The Hawaii Insurance Law" of the Hawaii Code of Laws, Secs. 181-6, 181-7. See also, 181-533, 534, 535, 536, 537, 538, 540, 541, 542, 544 and 643(h).

IDAHO: Title 41 "Insurance" of the Idaho Code (1948), with 1957 Cumulative Supplement, Sec. 41-201 and 41-304.

ILLINOIS: Title 73 "Insurance" of the Illinois Revised Statutes, 1953, and Supplements (also, Smith-Hurd Illinois Annotated Statutes, 1957 Supplement), Sec. 73-616, par. 4. See also Sec. 73-835, 836 and 839.

INDIANA: Title 39 "Insurance" of the Burns Indiana Statutes (Annotated), 1952 Replacement, Secs. 39-3203 and 39-3501.

IOWA: Title XX "Insurance" of the Iowa Code Annotated, 1949 (with 1958 Supplement), Sec. 508.31.

KANSAS: Chapter 40 "Insurance" of the General Statutes of Kansas, Annotated, 1949, and supplements, Sec. 40-401.

KENTUCKY: Chapter 304 "Insurance" of the Kentucky Revised Statutes, official edition, 1953, with supplements, Secs. 304.340 and 304.801.

LOUISIANA: Title 22 "Insurance Code" of the Louisiana Revised Statutes (1950) with 1957 Supplement Secs. 22:5 and 22:6. See also Secs. 22-163, 168, 172, 173, 174, 643, 647, 1061, 1062 and 1214.

MAINE: Chapter 60 "Insurance and Insurance Companies", of the Revised Statutes of Maine, 1954 edition (1957 cumulative supplement), Secs. 1, 170. See also, Sec. 139 and 140.

MARYLAND: Article 48A "Insurance" of the Annotated Code of Maryland (1957), Sec. 152.

MASSACHUSETTS: Title 22, chapters 174A and 175 "Insurance" of the General Laws of Massachusetts, Secs. 118 and 119. See also, Secs. 182, 183 and 184.

MICHIGAN: Title 24 "Insurance" of the Michigan Statutes Annotated (1957), Revised Volume, Secs. 24.1602.

MINNESOTA: Chapter 60 "Insurance Division" of the Minnesota Statutes (Annotated), Sec. 60.29 sub-paragraph (4).

MISSISSIPPI: Title 22 "Insurance" of the Mississippi Code, 1942, Recompiled (1957), Sec. 5654 and 5680.

MISSOURI: Title XXIV "Insurance" of Vernon's Annotated Missouri Statutes (1952) and 1958 Supplement (vol. 19), Sec. 376.010.

MONTANA: Title 40 "Insurance and Insurance Companies" of the Revised Code of Montana, 1947, Annotated (1957 Supplement), Secs. 40-101, 105, 1001, 1905.

NEBRASKA: Chapter 44 "Insurance" of the Revised Statutes of Nebraska, Revision of 1952, with 1958 Supplements, Secs. 44-201, 44-404.

NEVADA: Title 57 "Insurance and Insurance Companies", of the Nevada Revised Statutes (vol. 5), Sec. 681.020.

NEW HAMPSHIRE: Title XXXVII "Insurance" of the New Hampshire Statutes Annotated, 1955, Sec. 401.1.

NEW JERSEY: Title 17, subtitle 3 "Insurance" of the New Jersey Statutes Annotated, Permanent edition, with 1958 supplement, Sec. 17-1(c) and (e).

NEW MEXICO: Chapter 58 "Insurance" of the New Mexico Statutes Annotated, 1953, Secs. 58-1-1 and 58-7-1.

NEW YORK: "Insurance Law", of McKinney's Consolidated Laws of New York Annotated, vols. 27 and 28 (1949), with 1958 cumulative annual pocket supplement, Sec. 46, par. (4).

NORTH CAROLINA: Title 58 "Insurance" of the General Statutes of North Carolina, Secs. 58.195 and 58.72.

NORTH DAKOTA: Title 26 "Insurance" of the North Dakota Revised Code of 1943, Secs. 26-0201, 26-0501 and 26-0344. See also, Sec. 26-0802.

OHIO: Title 39 "Insurance" of the Baldwin's Ohio Revised Code, 1953, Annotated edition with supplement (also, Page's Ohio Revised Code, Annotated), Sec. 3907.01.

OKLAHOMA: Title 36 "Insurance" of the Oklahoma Statutes Annotated, permanent edition (1958), Sec. 702. See also, Secs. 4001-4029, inclusive.

OREGON: Title 56 "Insurance and Insurance Companies" of the Oregon Revised Statutes (1957 Replacement), Sec. 739.005.

PENNSYLVANIA: Title 40 "Insurance", of Purdon's Pennsylvania Statutes Annotated, Permanent Edition (1954), Sec. 382, 477(b) and 551.

RHODE ISLAND: Title 29 "Insurance" of the General Laws of Rhode Island, Sec. 29-4-12, 47-4-13.

SOUTH CAROLINA: Title 37 "Insurance" of the Code of Laws of South Carolina (1952), Secs. 3, 142.

SOUTH DAKOTA: Title 31 "Insurance" of the South Dakota Code, Secs. 31-0101, 31-2218, 31-1603 and chapter 57.35A "Insurance Premiums and Annuity Contracts".

TENNESSEE: Title 56 "Insurance" of the Tennessee Code (1955), Sec. 56-206.

TEXAS: Vol. 14 "Insurance Code" of Vernon's Texas Civil Statutes, Annotated (1952), Article 3.01.

UTAH: Title 31 "Insurance" of the Utah Code Annotated (1953 Supplement) Sec. 31-11-2.

VERMONT: Chapters 387-394 "Insurance" of the Vermont Statutes, Revised Edition, Sec. 9023.

VIRGINIA: Title 38 "Insurance" of the Code of Virginia (1950), Sec. 31-1-2.

VIRGIN ISLANDS: Title 22 "Insurance" of the Virgin Islands Code (1957), Sec. 3.

WASHINGTON: Title 48 "Insurance" of the Revised Code of Washington, Sec. 48.23.010, et seq,, "Life Insurance and Annuities", and Sec. 48.24, et seq., "Group Life and Annuities".

WEST VIRGINIA: Chapter 33 "Insurance and Annuity Contracts" of the West Virginia Code of 1949 (Annotated), with supplement, Sec. 3332.

WISCONSIN: Chapters 200-210 "Insurance" of the Wisconsin Statutes (1953), Sec. 201.04.

WYOMING: Title 52 "Insurance" of the Wyoming Compiled Statutes, Sec. 52-501.

APPENDIX II

(p. 6a)

(Face of Certificate)

CERTIFICATE OF AUTHORITY

DEPARTMENT OF INSURANCE — STATE OF ALABAMA

I, THE UNDERSIGNED, SUPERINTENDENT OF INSURANCE OF THE STATE OF ALABAMA, BY AUTHORITY VESTED IN ME BY LAW DO HEREBY AUTHORIZE THE LICENSEE NAMED BELOW TO ACT WITH POWERS INDICATED HEREON.

THIS CERTIFICATE EXPIRES DECEMBER 31 FOLLOWING THE EFFECTIVE DATE SHOWN BELOW UNLESS SUSPENDED OR REVOKED PRIOR THERETO.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, WASHINGTON, D. C.

COMPANY	EFFECTIVE DATE			POWER
2000	11	1	58	1
LICENSE NO.	MO.	DAY	YR.	OVER

SUPERINTENDENT OF INSURANCE

(Back of Certificate)

COMPANY POWERS

1. Life, Health, Accident, and Hospitalization
2. Fire and Allied Lines
3. Miscellaneous Casualty, excluding Official Surety Bonds
4. Miscellaneous Casualty, including Official Surety Bonds
5. Mutual Aid
6. Fraternal Benefit Societies
7. Non-Profit Hospital, Medical and Surgical
8. Reciprocal Exchange

APPENDIX III

State Corporation Commission
of New Mexico
Insurance Department

No. 216 **1958**

INSURANCE COMPANY LICENSE

It Is Hereby Certified, *That the* VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA *a corporation organized under the laws of* DISTRICT OF COLUMBIA *whose principal office is located at* WASHINGTON, D. C. *has complied with the requirements of the laws of this State applicable to said Company and is hereby authorized to transact the business of*

CLASS 1, LIFE, ACCIDENT AND HEALTH

(SEE REVERSE SIDE)

Insurance in accordance with its Charter or Certificate of Incorporation within

STATE OF NORTH DAKOTA

No. 6815

OFFICE OF THE COMMISSIONER OF INSURANCE

CERTIFICATE OF AUTHORITY

WHEREAS, The EQUITY ANNUITY LIFE INSURANCE COMPANY

a Corporation organized under the Laws of DISTRICT OF COLUMBIA
has filed in this office a sworn statement exhibiting its condition and business for the year ending December 31, 19 57.
conformable to the requirements of the Laws of this State regulating the business of insurance; and

WHEREAS, the said corporation has filed in this office a duly certified copy of its charter with certificate of organization in compliance with the requirements of the Insurance Laws aforesaid:

NOW, THEREFORE I, A. J. JENSEN, Commissioner of Insurance of the State of North Dakota, pursuant to the provisions of said Laws, do hereby certify that the above named corporation is fully empowered through its authorized agents to transact its appropriate business of

LIFE AND ANNUITIES ONLY

Insurance in this State, according to the Laws thereof, until the 30th day of April 19 59

IN TESTIMONY WHEREOF, I have hereunto set my hand and seal at Bismarck,
this 1st day of May 19 58

A. J. JENSEN Commissioner of Insurance.

By _____ Deputy

Buy "Dakota Maid" Flour

APPENDIX V

POLICY ENDORSEMENT

Provision 18 of this policy is modified by deleting the following phraseology:

> ". . . and less the sum of federal income taxes and other taxes, if such other taxes are measured by investment income and capital gains and losses, realized or unrealized, or either of them, accrued on policies of this class. . . ."

The purpose of this modification is to provide that federal income taxes and other taxes measured by investment income and capital gains and losses, realized or unrealized, levied against the Company shall not be considered in determining the total investment experience of the Company each month.

/s/

President
Variable Annuity Life Insurance Company of America

DA-1000-El

APPENDIX VI

Disclosure Requirements and Penalties for Misrepresentation Under the District of Columbia Code, Title 35 Insurance

§ 35-103. *Annual Statements—Statement to be published in newspaper.*

The said superintendent shall furnish, in December of each year, to every insurance company or association, local, domestic, and foreign, doing business in the District of Columbia, or its agent or attorney in the District, the necessary blank forms for the annual statements for such company or association, which shall be returned to the superintendent on or before the first day of March in each year, signed and sworn to by the president or vice-president and secretary or assistant secretary, or, if a foreign company, by its manager or proper representative within the United States, showing its true financial condition as of the next preceding 31st day of December, which shall include a statement of its assets and liabilities classified according to regulations made by the Superintendent of Insurance on that day, the amount and character of business transacted, losses sustained, and money received and expended during the year, and such other information as the said superintendent may deem necessary. Such annual statements shall be printed in at least one daily newspaper published in the District of Columbia, in the month of March in each year; and any such company or association failing to comply with the provisions aforesaid shall have its license to do business in the District revoked.

§ 35-106. *Superintendent to make annual report.*

The Superintendent of Insurance shall report annually to the commissioners of the District, on or before the thirty-first day of March, the financial condition of each insurance company and association doing business in said District, as of the thirty-first day of December next preceding.

§ 35-107. *Superintendent's reports to be bound.*

After May 18, 1910, the annual reports of the Superintendent of Insurance shall be printed and bound in one volume, and shall be ready for distribution not later than the first day of the next regular session of Congress thereafter.

§ 35-204. *Principal office to be in District of Columbia—Keeping and removing of records . . . .*

Any corporation now or hereafter formed or organized under any provision of law in force and effect in the District of Columbia to engage in an insurance business shall maintain its principal office within said District and shall keep its books, records, and files therein, and shall not remove from said District either its principal office or its books, records, or files without the permission of the Commissioners of the District of Columbia first had and obtained: . . :

§ 35-407. *Annual statement—Verification—Failure to make.*

Every company doing business in the District shall file with the superintendent before March 1 in each year a financial statement for the year ending December 31, immediately preceding, on forms furnished by the superintendent. Such statement shall be verified by the oaths of the president and secretary of the company, or, in their absence by two other principal officers. The statement of an alien company shall embrace only its condition and transactions in the United States and shall be verified by the oath of its resident manager or principal representative in the United States. In case a company shall fail to make and file its annual statement within the time herein prescribed its authority to transact business in the District shall thereupon terminate. (June 19, 1934, 48 Stat. 1132, ch. 672, § 8, ch. II)

§ 35-408. *Penalty for false statement.*

A director, officer, agent, or employee of any company who wilfully and knowingly subscribes, makes, or concurs in making or publishing any annual or other statement required by law, containing any material statement which is false, shall, upon conviction thereof, be punished by imprisonment in the penitentiary for not less than two nor more than ten years. A person who wilfully and knowingly makes oath to any such false statement shall be guilty of perjury. (June 19, 1934, 48 Stat. 1132, ch. 672, § 9, ch. II.)

§ 35-418. *Examinations—Reports—Verification—Hearing upon—Publication—Expense.*

The superintendent may examine the books, papers, property, and the affairs of any insurance company organized or doing business in the District and of any company engaged in or professing to be engaged in organizing, promoting, or soliciting stock or capital contributions to or aiding in the formation of an insurance company or of any company which holds the capital stock of an insurance company for the purpose of controlling the management thereof as voting trustees or otherwise. The superintendent, his deputy, or any examiner may examine under oath the officers and agents of such company and all persons deemed to have material information regarding the company's property or business.

* * * * * * * * * *

The superintendent shall grant a hearing to the company examined, or he shall furnish it a copy of his report, in tentative form, requesting that the statements and items therein contained be checked, and the report be returned to the superintendent within the time specified by him, before filing any such report and before making public such report or any matters relating thereto; and may withhold any such report from public inspection for such

time as he may deem proper; and may after so filing, if he deems it for the interest of the public to do so, publish any such report or the result of any such examination as contained therein in one or more newspapers in the District without expense to the company. It shall be the duty of the superintendent to examine every domestic insurance company at least once in three years.

The expense of every such examination, not to include salaries, shall be paid by the company examined, and such company shall pay to the superintendent, his deputies, and/or his examiners the actual expense of such examination upon itemized bills furnished by the superintendent. (June 19, 1934, 48 Stat. 1135, ch. 672, § 19, ch. II.)

§ 35-530. *Officers and directors not to be pecuniarily interested in transactions . . .*

No director or officer of any company doing business in the District shall receive any money or valuable thing for negotiating, procuring, recommending, or aiding in any purchase by or sale to such company of any property, or any loan from such company, nor be pecuniarily interested, either as principal, coprincipal, agent, or beneficiary, in any such purchase, sale, or loan, nor shall the financial obligation of any such director or officer be guaranteed by such company in any capacity: . . . (June 19, 1934, 48 Stat. 1151, ch. 672, § 30, ch. III)

§ 35-714. *Misrepresentations prohibited.*

No life company doing business in the District, and no officer, director, general agent, agent, or solicitor thereof, broker, or any other person shall make, issue, or circulate, or cause to be issued or circulated, any estimate, illustration, circular, or statement of any sort misrepresenting the terms of any policy issued or to be issued by it or the benefits or advantages promised thereby, or the dividends or shares of the surplus to be received thereon, or shall use any name or title of any policy or class of policies mis-

a corporation organized under the laws of DISTRICT OF COLUMBIA

whose principal office is located at WASHINGTON, D. C.

has complied with the requirements of the laws of this State applicable to said Company and is hereby authorized to transact the business of

CLASS 1, LIFE, ACCIDENT AND HEALTH

(SEE REVERSE SIDE)

Insurance in accordance with its Charter or Certificate of Incorporation within the State of New Mexico, subject to the provisions and requirements of law until the last day of February in the year of our Lord one thousand nine hundred and fifty-nine.

In Witness Whereof, *The Superintendent of Insurance of the State of New Mexico has caused this license to be signed and the seal of said Superintendent to be affixed hereto at the city of Santa Fe, this* 31ST *day of* DECEMBER *A.D., 1958*

SUPERINTENDENT OF INSURANCE

11

representing the true nature thereof. Nor shall any such corporation or officer, director, general agent, agent, or solicitor thereof, broker or any other person, firm, association, or corporation make any misrepresentation to any person insured in any company for the purpose of inducing or tending to induce a policyholder in any company to lapse, forfeit, or surrender his insurance. It shall be the duty of the superintendent, upon due proof after notice and hearing that any such company or agent thereof has violated any of the provisions of this section, to revoke the authority of the company or agent so offending: *Provided, however,* That the action of the superintendent in this regard shall be subject to appeal and review in the form and manner prescribed in section 35-427. (June 19, 1934, 48 Stat. 1174, ch. 672, § 14, ch. V.)